

ESTABLISHING CONSISTENT ENFORCEMENT POLICIES IN THE CONTEXT OF ONLINE WAGERS

HEARING BEFORE THE COMMITTEE ON THE JUDICIARY HOUSE OF REPRESENTATIVES ONE HUNDRED TENTH CONGRESS FIRST SESSION

NOVEMBER 14, 2007

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ESTABLISHING CONSISTENT ENFORCEMENT POLICIES IN THE CONTEXT OF ONLINE WA- GERS

WEDNESDAY, NOVEMBER 14, 2007

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Committee met, pursuant to notice, at 10:09 a.m., in Room 2141, Rayburn House Office Building, the Honorable John Conyers, Jr. (Chairman of the Committee) presiding.

Present: Representatives Conyers, Berman, Scott, Jackson Lee, Wexler, Cohen, Sherman, Baldwin, Ellison, Smith, Coble, Goodlatte, Chabot, Issa, Feeney, Franks, and Gohmert.

Staff present: Gregory Barnes, Majority Counsel; Michael Volkov, Minority Counsel; and Teresa Vest, Chief Clerk.

Mr. CONYERS. Good morning, all. Let us begin the hearing. We have the dazzling diva of Las Vegas as a congressional witness, and then our ordinary Member from Virginia, Bob Goodlatte, former chairman of Agriculture and long-time serving Member of Judiciary.

We welcome you both here, and we want to have you set the tone for us. The only thing I want to say before yielding to Mr. Smith is that we have a dilemma here. Gambling is a social evil, but the enforcement of it is sort of selectively picked and chosen. We have loopholes in the current system. There are people now beginning to talk about regulating, rather than banning. We have concerns about the rights of States over the Federal system, which we will hear about.

They are telling us that some games are so much skill and so little chance that they shouldn't even be called gambling, per se. The only people not organized to my knowledge, Ranking Member Smith, are the crap-shooters, the guys that roll the dice. They don't have an association. They don't have anybody speaking up for them. They don't have lobbyists. So maybe, I hope I am not encouraging them to do something about it.

But it is a pleasure to have our colleagues here. I am going to put my written statement in the record and yield to Lamar Smith.

[The prepared statement of Chairman Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF MICHIGAN, AND CHAIRMAN, COMMITTEE ON THE
JUDICIARY

Today's hearing is on the Internet and the need to establish consistent enforcement policies in the context of online wagers.

At last count, federal prosecutors had at least six major federal laws at their disposal to go after and prosecute unlawful gaming activities. These laws include: the Wire Act, the Travel Act, RICO, the general prohibition against money laundering, the ban on illicit gambling operations, and the recently enacted "*Unlawful Internet Gambling Enforcement Act of 2006*." Yet, despite such far reaching tools, questions still persist in the area of online gambling.

Namely, we find ourselves questioning the selective nature of the federal government's enforcement efforts, to date. Indeed, for several years now, members of this Committee have heard repeated claims that the Wire Act prohibits several forms of online gambling, but we fail to see it enforced in the context of interstate bets connected to horseracing.

Second, questions continue to persist as to whether the current approach establishes a workable framework, in terms of preventing unlawful gambling from occurring. Just last year, as previously mentioned, Congress passed the *Unlawful Internet Gambling Enforcement Act of 2006*. And, at the time of the bill's passage, proponents of the measure claimed that the legislation was absolutely necessary to "bring an end to unlawful online gaming once and for all."

A few days ago, however, we got a chance to review the Treasury Department's proposed implementing regulations. And, the proposed regulations make clear that many forms of online gambling will continue to proceed unfettered, despite the new set of regulations. To make matters worse, there's strong evidence that the new regulations will prohibit certain activities that are perfectly legal.

The final question confronting us today relates to the viability of any ban given the nature of the internet and the infrastructure it uses. Admittedly, our track record thus far on this topic hasn't been too successful. In fact, our latest approach not only threatens legitimate businesses; it also poses substantial problems for the intellectual property community, as witnessed by the latest proceedings taking place before the World Trade Organization. Not to mention the fact that the current approach does very little to prevent underage gambling or thwart possible acts of money laundering.

Continuing with the same old failed policies for the sake of feel good politics doesn't make sense. We can do better. We must do better.

Mr. SMITH. Thank you, Mr. Chairman.

I do want to thank you for holding today's hearing because I think Internet gambling is a very important subject. And also at the outset, I want to commend my colleague, Congressman Bob Goodlatte, who is with us today, for his commitment to this issue. He has worked for years on the problem of Internet gambling.

The dangers of Internet gambling are well known. According to law enforcement officials, Internet gambling sites are often fronts for money laundering, drug trafficking, and criminal organizations. Furthermore, these sites evade gambling regulations that restrict gambling by minors, protect chronic gamblers, and ensure the integrity of the games. Young people and compulsive gamblers are particularly vulnerable.

The characteristics of Internet gambling are unique. Online players can gamble 24 hours a day from home. Children may play without age verification, and betting with a credit card can lead to addiction, bankruptcy, and crime. Just over a year ago, Congress enacted the Unlawful Internet Gambling Enforcement Act. The act prohibits the acceptance of financial payments for unlawful Internet gambling. The law has, in fact, had its intended effect. It has reduced the availability of Internet gambling.

Many of the major players in the industry, such as publicly traded companies in the United Kingdom, have stopped their U.S. operations. For example, the Financial Times reported that PartyGaming quit the United States market entirely. The act has reduced gambling by young people. A recent study conducted by the National Annenberg Survey Center found that weekly use of the Internet for gambling among college-age youth declined from

5.8 percent in 2006 to 1.5 percent in 2007. For college-age males, monthly Internet gambling dropped from 8.9 percent to only 2.9 percent.

Even with these obvious benefits, media reports show that major Internet gambling companies are seeking to undo the prohibition against Internet gambling. Legislation has been introduced to legalize, tax, and regulate Internet gambling. Turning back the clock to permit Internet gambling will only encourage the problems we hope to avoid.

At today's hearing, I am especially interested in learning more about the Treasury and Justice Departments' current enforcement efforts and their need for additional authorities or resources to tackle the problem of Internet gambling.

Mr. Chairman, I yield back the balance of my time. Also, I certainly agree with you. I think we can eliminate going after the dice-throwers. [Laughter.]

Mr. CONYERS. Thank you very much, Mr. Smith.

Bob Wexler is dying to make a statement, but I am not going to let him do it. I will recognize him first, though, when we begin our witnesses, or begin our Members' asking questions. Chairman Scott has graciously agreed to let you go first.

We turn now to Shelley Berkley herself—fifth term, Ways and Means, Veterans Affairs. If anyone has been in or out of the state of Nevada and not seen Shelley Berkley, then something was wrong with their schedule. We are happy to have her begin this discussion. As Lamar Smith said, there are at least five laws on the books federally—RICO, Wire, money laundering. There is another one coming down the pike. So let us find out what the state of play is and we are welcome to have Ms. Berkley with us this morning.

TESTIMONY OF THE HONORABLE SHELLEY BERKLEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEVADA

Ms. BERKLEY. Thank you very much, Mr. Chairman. I appreciate the opportunity to testify before the Committee today on the issue of Internet gaming. As you can certainly attest, Mr. Chairman, I have been requesting a hearing on this topic for some time. As Las Vegas' representative in Congress, and as the only Member of this body that has worked in the gaming industry, I feel I can offer the Committee an important perspective on this ongoing debate.

I think the use of the word "consistent" in the title of today's hearing helps highlight the absurdity of the current situation with respect to Internet gaming. A combination of outdated laws, selective enforcement by the Justice Department, and an intentional lack of clarity by Congress resulted in a confusing environment for those law-abiding Americans who want to wager online, and that was before enactment of last year's Unlawful Internet Gambling Enforcement Act.

The law actually made things worse by targeting the financial sector and creating a hypocritical carve-out for horseracing. Now, I don't know how those who say they are protecting the morals of their fellow Americans by prohibiting legal online betting can reconcile that with their equal enthusiasm to protect online horserace betting.

After the vote last year, in which the ban on Internet gaming was sneaked into the Port Security bill, which was a must-pass bill, the horserace industry reps declared that this ban on online gaming was the biggest boon to their industry ever. If the Committee would like me to submit the direct quotes, I would be glad to do so.

Although some Internet gaming executives have been arrested and reputable operators have stopped doing business in the United States, an estimated 10 million Americans are still wagering online on poker alone, and Mr. Smith, if you think for a minute that the kids on the college campuses and the dormitories aren't betting online, you need to go visit some of them. They all are.

Americans are still wagering online even with this ban, and they are doing so without the benefit of protections afforded by Federal regulatory oversight.

Mr. SMITH. Since you mentioned my name, let me respond. Yes, I know they are, but my point was, and the figures that I cited, shows how dramatically they have dropped as a result of last year's bill.

Ms. BERKLEY. I would challenge that assertion.

In this era of global economy, this situation has only caused consternation among our closest trading partners. The WTO has ruled that our laws banning Internet gaming unfairly discriminate, and now the U.S. is on the hook for what could be a substantial penalty.

The Bush administration responded to this embarrassing defeat in the WTO by seeking to withdraw any gambling-related service from our WTO commitments, opening us up to further liability in the form of compensation to the EU, Australia, Japan, and other allies. This is the trade equivalent of taking our ball and going home, and sets a dangerous precedent for other nations. You can be sure that if China one day decides that it shouldn't have to comply with its WTO obligations, we will be the first to object.

So where do we go from here? I applaud this Committee for attempting to lay the groundwork for a legislative solution that ideally would legalize online gaming, subject it to some sort of regulation, and protect underage and problem gamblers. There are several pieces of legislation pending—Mr. Wexler's poker carve-out, Mr. Frank's financial instruments bill.

I have also introduced legislation calling for a 1-year study by the National Research Council on this issue, something that should have been done before we went forward with last year's ban. I can't imagine why anybody would be opposed to actually having a congressionally authorized full-fledged study to determine whether or not the assertions that are made by the anti-Internet gaming people are true, or if they are not.

I encourage the Committee to consider my bill so that we can have the unbiased information we need to make informed decisions on what is a very complicated topic.

Now, may I say I grew up in Las Vegas. If you go to the grocery store for a container of milk, there are slot machines. If you want to take your kids to a movie, you go into a casino. That is where our movies are located. If you want to go bowling, if you belong to a bowling league, all the bowling alleys are in the casinos.

If you want to go take your family for Sunday brunch after church, you go into a casino and you have brunch in the casino. I have been exposed to casinos and gambling my entire life. I have neither an interest in gambling nor do I have an addiction.

For those that claim that they are worried about problems gambling and underage gaming, there is technology available to identify these people and prevent them from betting online. There are 28 million self-identified poker players who want to play and bet online. They are adults who as American citizens have a right to play poker, a game of skill, in the privacy of their own homes on their own computers.

There is a limit to how much government can interfere with our fellow citizens' rights to participate in a recreational activity of their choice. As far as addiction is concerned, there are far more people addicted to shopping online than gambling online. Unless Congress is going to ban Internet shopping, we better think long and hard about prohibiting people from Internet gaming because that is an area that government has no business intruding into.

I urge this Committee to move forward with my study bill. Let us get the facts. Mr. Chairman, you mentioned that gambling in your opening remarks is a social evil. I respectfully would disagree with you. I grew up in Las Vegas. My father was a waiter when I was growing up. On a waiter's salary in Las Vegas, he put a roof over our head, food on the table, clothes on our backs, and two daughters through college and law school. Not so bad on a waiter's salary. The reason that was possible was because we have a strong economy fueled by the gaming industry. I don't see a social evil there.

With that, I yield back the balance of my time.

[The prepared statement of Ms. Berkley follows:]

PREPARED STATEMENT OF THE HONORABLE SHELLEY BERKLEY, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF NEVADA

Thank you Mr. Chairman. I appreciate the opportunity to testify before the committee today on the issue of Internet gaming. As you can attest, Mr. Chairman, I have been agitating for a hearing on this topic for some time. As Las Vegas' representative in Congress, and as the only member of this body with actual gaming experience, I feel I can offer the committee an important perspective on this ongoing debate.

I think the use of the word "consistent" in the title of today's hearing helps highlight the absurdity of the current situation with respect to Internet gaming. A combination of outdated laws, selective enforcement by the Justice Department, and an intentional lack of clarity by Congress resulted in a confusing environment for those law-abiding Americans who want to wager online, and that was before enactment of last year's so-called Unlawful Internet Gambling Enforcement Act. The UIGEA actually made things even more confusing by targeting the financial sector rather than gamblers, and further memorializing the carve-out for horseracing. Although some Internet gaming executives have been arrested and some of the more reputable operators have stopped doing business in the U.S., an estimated 10 million Americans are still wagering online on poker alone, and they are doing so without the benefit of the protections afforded by effective regulatory oversight.

In this era of the global economy, this situation has also caused consternation among our closest trading partners who have been shut out of a potentially lucrative market. The WTO has ruled that our laws unfairly discriminate against Antigua, and now we're on the hook for what could be a substantial penalty. The Bush administration responded to this embarrassing defeat by seeking to withdraw any gambling-related service from our WTO commitments, opening us up to further liability in the form of compensation to the EU, Australia, Japan, and other allies. This is the trade equivalent of taking our ball and going home, and sets a dangerous

precedent for other nations. You can be sure that if China one day decides that it shouldn't have to comply with its WTO obligations, we will be the first to object.

So where do we go from here? I applaud this committee for attempting to lay the groundwork for a legislative solution that ideally would legalize online gaming, subject it to some sort of regulation, and protect underage and problem gamblers. While this debate continues, I have introduced legislation calling for a one-year study by the National Research Council on these very issues, something that should have been done before we went forward with last year's ban. I encourage the committee to consider my bill so that we can have the unbiased information we need to make informed decisions on what is a very complicated topic.

Thank you again for holding this hearing.

Mr. CONYERS. Thank you. We on the Committee feel we got off light, Shelley, this morning. [Laughter.]

You are very kind and understanding of our approach to this matter. We do remember, though, and know that you are not ordinary. You are quite special. So I am not quite sure if we can use your experience as the prototypical model that we would emulate. But I am glad that you represent in person the fact that you can grow up around gaming or gambling and that it can reap very good results. I thank you for that.

Bob Goodlatte is a Member of this Committee in his eighth term. He has divided his career between Judiciary and Agriculture. He has been the Chairman of that latter Committee. He is one of our experts in particular areas in the Judiciary Committee. We welcome him to come before the Committee at this time. Of course, we will include all the statements of our guest Members of Congress and Members of the Committee in the record.

Welcome, Bob.

TESTIMONY OF THE HONORABLE BOB GOODLATTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. GOODLATTE. Thank you, Mr. Chairman. I appreciate your inviting me to testify on this important issue. It is a pleasure to be here with my colleague from Las Vegas, Ms. Berkley.

Let me start by saying that I concur with your observation about the social ills of gambling. Contrary to what many in the gambling community would lead you to believe, gambling is not a victimless activity. In fact, the negative consequences of online gambling can be more detrimental to the families and communities of addictive gamblers than if a bricks-and-mortar casino was built right next door or in your community like Las Vegas, because Las Vegas and other communities like that have an organized regulatory structure that the Internet is not suited for.

Sadly, I have even been contacted by a constituent in my district whose son fell prey to an Internet gambling addiction. Faced with insurmountable debt from Internet gambling, he took his own life. Unfortunately, financial ruin and tragedy are not uncommon among online bettors.

We are all familiar with the Lehigh University student body president who last year was arrested for armed robbery to pay an Internet gambling debt. We are aware of the family problems, the youth gambling problems, the addictive gambling problems, the organized crime problems, the bankruptcy problems that occur with gambling.

Traditionally, States have had the authority to permit or prohibit gambling that occurs wholly within their borders. Indeed, State

gambling laws vary greatly, with states like Nevada, represented by Ms. Berkley, that allow and regulate almost every form of gambling. The neighboring state of Utah bans every form of gambling.

With the development of the Internet, however, State prohibitions and regulations governing gambling have become increasingly hard to enforce as electronic communications, and thus illegal bets and wagers, move freely across borders. Congress has acted to help enforce State laws before.

In 1961, Congress passed the Federal Wire Act which cracked down on illegal gambling operations that were using telephone lines to communicate bets and wagers across State lines in violation of State law. Today the Internet and wireless technologies are the preferred method of communicating illegal bets and wagers across State lines and we need to make sure the law also contemplates Internet transactions.

While the Department of Justice continues to state publicly that the Wire Act covers Internet technologies and also covers all forms of gambling, it has also welcomed legislation to clarify these provisions. Virtually all State law enforcement agencies support Federal laws to give teeth to their gambling laws. Last Congress, 48 of the 50 State attorneys general signed a letter to Congress calling for legislation to combat Internet gambling.

In order to provide more tools to law enforcement, the House of Representatives passed H.R. 4411 last Congress by an overwhelming bipartisan vote of 317 to 93. This legislation was perhaps the strongest legislation prohibiting Internet gambling that has been considered on the House floor in the past few decades. It contained important provisions to update and clarify the Wire Act, as well as a new tool to require financial transaction providers to block payments of illegal bets and wagers.

Contrary to the assertions of some that there was no public debate on this bill, this legislation was the subject of hearings and markups in the Judiciary and Financial Services Committees, as well as a robust debate on the House floor. Ultimately, only the portion of the bill blocking illegal Internet gambling payments was signed into law. In keeping with previous laws, the new law only applies to transactions that violate State and Federal gambling laws, thus continuing to leave the decision of whether to allow or prohibit gambling primarily to the States.

While it was only one piece of the broader House-passed bill, this new law, coupled with stepped-up enforcement actions by the Department of Justice, has already proven extremely effective. A new study by the Annenberg Public Policy Center, cited by the Ranking Member, Mr. Smith, shows that card playing for money among college-age youth has declined from 16.3% in 2006 to 4.4% in 2007. The same study shows that weekly use of the Internet for gambling among the same age bracket has declined from 5.8% in 2006 to 1.5% in 2007.

Perhaps even more promising is the fact that problem gambling symptoms have declined since last year. Among males ages 18 to 22, those who reported some type of gambling on a weekly basis and who also reported at least one symptom of problem gambling dropped from 20.4% in 2006 to 5.9% in 2007.

This has been aided significantly by recent significant prosecutions by the Department of Justice, most notably some of the publicly traded online gambling interests, some of the largest have done that, have withdrawn from our market, and NetTeller, which announced that it would continue in the market notwithstanding the legislation passed by Congress, quickly withdrew from the market after two of its directors were prosecuted. They were transferring over \$6 billion a year outside the country and may well account for the largest gain in the significant reduction we have experienced in online gambling since last year.

The Department of Treasury has issued draft regulations implementing the anti-gambling statute we passed last Congress, and it is my understanding that there will be a witness in the next panel to explain in detail the proposed regulations.

While there is overwhelming bipartisan Congressional support for a strong ban on Internet gambling, as reflected by the vote in the House just last year, that has not stopped many in Congress from introducing legislation this year to overturn and even reverse the new Federal statute, to exempt poker and other forms of gambling from the law, and to study whether we should regulate Internet gambling.

These types of bills are premature at best since the regulations have not even been finalized yet. At worst, these bills have the potential to reverse the positive trend mentioned above of reducing addictive behaviors that destroy the lives, families, and financial well-being of America's citizens.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Goodlatte follows:]

PREPARED STATEMENT OF THE HONORABLE BOB GOODLATTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. Chairman, thank you for inviting me to testify on this important issue.

Contrary to what many in the gambling community would lead you to believe, gambling is not a victimless activity. In fact, the negative consequences of online gambling can be more detrimental to the families and communities of addictive gamblers than if a bricks-and-mortar casino was built right next door.

The anonymity of the Internet makes it much easier for minors to gamble online. Furthermore, online gambling can result in addiction, bankruptcy, divorce, crime, and moral decline just as with traditional forms of gambling, the costs of which must ultimately be borne by society. In fact, I have been contacted by a constituent in my district whose son fell prey to an Internet gambling addiction. Faced with insurmountable debt from Internet gambling, he took his own life. Unfortunately, financial ruin and tragedy are not uncommon among online bettors.

Traditionally, States have had the authority to permit or prohibit gambling that occurs wholly within their borders. Indeed, state gambling laws vary greatly with states like Nevada permitting and regulating virtually all gambling and states like Utah prohibiting virtually all forms of gambling.

With the development of the Internet, however, state prohibitions and regulations governing gambling have become increasingly hard to enforce as electronic communications move freely across borders. Many gambling operations are beginning to take advantage of the ease with which communications can cross state lines in order to elicit illegal bets and wagers from individuals in jurisdictions that prohibit those activities. The most egregious types of these operations are those overseas operations that have little fear of violating U.S. and state laws.

Congress has acted in this area before. In 1961 Congress passed the Federal Wire Act which cracked down on illegal gambling operations that were using telephone lines to communicate bets and wagers across state lines in violation of state law. This statute was passed to help states enforce their own gambling laws, and was cutting-edge at the time. However, today the Internet and wireless technologies are the preferred method of communicating illegal bets and wagers across state lines

and we needed to make sure the law contemplates Internet transactions, as well as traditional wire communications.

Virtually all State law enforcement agencies support federal laws to give teeth to their gambling laws. Last Congress, 48 Attorneys General signed a letter to Congress calling for legislation to combat Internet gambling. The letter declared that "We, the undersigned Attorneys General, wish to express our strong support for the efforts of the 109th Congress to pass legislation seeking to combat illegal Internet gambling in the United States. While we do not support federal preemption of our state laws related to the control of gambling, Internet gambling transcends state and jurisdictional boundaries and requires that all segments of the law enforcement community (state, federal and local) work together to combat its spread."

The Department of Justice has consistently stated publicly that it believes that the Wire Act covers Internet technologies and also covers all forms of gambling. However, DOJ has also welcomed legislation to clarify these provisions in order to allow it to more efficiently prosecute violations. One only has to look as far as the prosecutions of the payment processing company NETeller and the Internet gambling site Betonsports to see that DOJ can and does aggressively and effectively enforce the laws.

In order to provide more tools to law enforcement, the House of Representatives passed H.R. 4411 last Congress by an overwhelming bipartisan vote of 317-93. This legislation was perhaps the strongest legislation prohibiting Internet gambling that has been considered on the House Floor in the past few decades. It contained important provisions to update the Wire Act, including clarifying that it covers all forms of gambling as well as all forms of technology that allow interstate gambling activities to occur. This legislation also contained important provisions to give law enforcement an additional tool to prohibit illegal Internet gambling, namely, it required financial transaction providers to block payments of illegal bets and wagers. This legislation was the subject of hearings and markups in the Judiciary and Financial Services Committees, as well as robust debate on the House Floor.

Ultimately, only the portion of the bill blocking illegal Internet gambling payments was signed into law. In keeping with previous laws, the new law only applies to transactions that violate state and federal gambling laws, thus continuing to leave the decision of whether to allow or prohibit gambling primarily with the states.

While it was only one piece of the broader House-passed bill, this new law, coupled with stepped-up enforcement actions by DOJ, has already proven extremely effective. A new study by The Annenberg Public Policy Center shows that card playing for money among college-age youth has declined from 16.3% in 2006 to 4.4% in 2007. The same study shows that weekly use of the Internet for gambling among the same age bracket has declined from 5.8% in 2006 to 1.5% in 2007. Perhaps even more promising is the fact that problem gambling symptoms have declined since last year. Among males ages 18-22, those who reported some type of gambling on a weekly basis and who also reported at least one symptom of problem gambling dropped from 20.4% in 2006 to 5.9% in 2007.

The Department of Treasury has issued draft regulations implementing the anti-gambling statute we passed last Congress, and it is my understanding that there will be a witness in the next panel to explain in detail the proposed regulations.

While there was overwhelming bipartisan Congressional support for a strong ban on Internet gambling in the House just last year, that has not stopped many in Congress from introducing legislation this year to overturn and even reverse the new federal statute, including legislation to override all state laws and permit all Internet gambling at the federal level and legislation to exempt poker and other forms of gambling from the definition of bets and wagers in the law. These types of bills are premature at best since the regulations have not even been finalized yet. At worst, these bills have the potential to reverse the positive trend mentioned above of reducing addictive behaviors that destroy the lives, families, and financial well-being of America's citizens.

Thank you again for allowing me to testify on this important issue.

Mr. CONYERS. Thank you so much. We appreciate that.

Are you okay with a study, Bob?

Mr. GOODLATTE. Mr. Chairman, I think the most appropriate thing to do right now is to have the new law take effect and have enforcement of that measure operate. And then if at some point in the future it appears that questions arise about whether it is effective, a study would be appropriate. But I don't believe a study is

necessary at this point in time. What I think would be appropriate would be to see stepped-up enforcement and implementation of the new regulations that the Treasury Department has put forward.

Mr. CONYERS. Thank you.

The last word goes to the lady.

Ms. BERKLEY. I would respectfully disagree with my colleague on whether or not a study is warranted. The reality is the study should have been conducted before the ban on Internet gaming was passed initially. What Mr. Goodlatte asserts as the negative consequences of Internet gaming are the exact same negative consequences that the anti-gaming people bring out and talk about every time there is a bill that would eliminate some form of gaming. There is nothing new in what he is saying.

I believe it would be responsible on the part of Congress that we actually had a congressional study by the National Academy of Sciences to determine whether or not there are negative impacts caused by Internet gaming. I cannot imagine why anybody would be opposed to it. We should have done this a year ago before we banned the sport.

Mr. CONYERS. Well, thank you. This has been a good way to start us off. I would like to call up now our witnesses on the second panel: The Honorable Catherine Hanaway, Ms. Valerie Abend, Professor Joseph Weiler, Ms. Annie Duke, Tom McClusky, and Michael Colopy.

If you would all join us? I will start with our United States Attorney for the Eastern District of Missouri, from the Department of Justice, Catherine Hanaway. She was the former Speaker of the House of the State of Missouri, and is a lawyer, graduated Catholic University of America, Columbus School of Law. We are delighted to have you here. We have everyone's testimony that will be included in the record. You may begin your discussion. Welcome.

**TESTIMONY OF THE HONORABLE CATHERINE L. HANAWAY,
UNITED STATES ATTORNEY, EASTERN DISTRICT OF MISSOURI,
U.S. DEPARTMENT OF JUSTICE**

Ms. HANAWAY. Thank you, Mr. Chairman, Members of the Committee. Good morning. My name is Catherine Hanaway. I am the United States Attorney in the Eastern District of Missouri. I am pleased to offer the views of the Department of Justice about Internet gambling.

As you all know, gambling in the cyber-world takes on many different forms. The Department of Justice's view is and has been for some time that all forms of Internet gambling, including sports wagering, casino games and card games, are illegal under Federal law. While many of the Federal statutes do not use the term "Internet gambling," we believe that the statutory language is sufficient to cover it.

As we have noted on several occasions, the Department believes that Internet gambling should remain illegal. As set forth more fully in my prepared testimony, the Department of Justice has concerns about Internet gambling because it poses an unacceptable risk due to the potential for gambling by minors and for compulsive gambling. Current cases also show the potential for fraud and

money laundering, and the involvement of organized crime in on-line gambling.

As we have stated on previous occasions, the Department interprets existing Federal statutes, including 18 U.S.C. Sections 1084, 1952, and 1955, as pertaining to and prohibiting Internet gambling. In October, 2006, the Unlawful Internet Gambling Enforcement Act, also known as the UIGEA, was enacted. This statute was codified at 31 U.S.C. Sections 5361 through 5367, and it prohibits the acceptance of specified forms of payment for unlawful Internet gambling by a business of betting or wagering.

It is the view of the Department that Internet gambling was illegal under existing Federal criminal statutes even before the UIGEA. Since the enactment of this statute, several Internet gambling businesses have ceased accepting bets and wagers from individuals in the United States.

The UIGEA required the Department of Treasury and the Board of Governors of the Federal Reserve, in consultation with the attorney general, to issue regulations to implement applicable provisions of the UIGEA. These agencies consulted with the Department during the drafting process. The regulations were published for public comment in the Federal Register on October 4, 2007. The time period for the public to submit comments on the proposed regulations to the Department of Treasury or to the Board of Governors of the Federal Reserve ends on December 12, 2007.

The Department of Justice continues to prosecute illegal gambling over the Internet. Most of the prosecutions are the result of joint investigations by Federal and State law enforcement agencies. As set forth more fully in my prepared statement, the United States has several successful and ongoing prosecutions.

For example, in the NetTeller prosecution in the Southern District of New York, the company NetTeller admitted criminal wrongdoing and agreed to forfeit \$136 million for its part in a conspiracy to promote illegal Internet gambling businesses and to operate an unlicensed money-transmitting business.

Two founders of NetTeller pled guilty to conspiracy charges. Other cases have been charged and are awaiting trial. For example, on June 28, 2007, in the Eastern District of Missouri, the Federal grand jury returned a superseding indictment in *United States v. BetonSports, PLC, et al.* BetonSports was a publicly traded company that owns a number of Internet sports books and casinos. The company, BetonSports, pled guilty to Federal racketeering charges on May 24, 2007.

In addition to these prosecutions, the Department also has reached several settlements concerning Internet gambling. In January, 2006, the United States Attorney's office in St. Louis announced a \$7.2 million settlement with the Sporting News to resolve claims that the Sporting News promoted illegal gambling from early 2000 through December, 2003, accepting fees in exchange for advertising illegal gambling. As part of the settlement, the Sporting News is conducting a public service campaign to advise the public of the illegality of commercial Internet and telephonic gambling.

On behalf of the Department of Justice, I want to thank you for inviting me to testify today. We thank you for your support over

the years, and reaffirm our commitment to work with Congress to address the significant issue of Internet gambling. I will be happy to take any questions you want to ask.

[The prepared statement of Ms. Hanaway follows:]

PREPARED STATEMENT OF CATHERINE L. HANAWAY

Before the**U.S. House of Representatives
Committee on the Judiciary****November 14, 2007**

Good morning, Mr. Chairman. Thank you for inviting me to testify today. My name is Catherine L. Hanaway. I am the United States Attorney for the Eastern District of Missouri. Today I am pleased to offer the views of the Department of Justice on the issue of Internet gambling.

Background

As in the physical world, gambling in the cyber world takes many different forms. In some instances, the operator of the website runs the gambling operation, including processing of payments, and bets and wagers are transmitted via the website. In other instances, payment and collection of monies are conducted in person while the placement of bets occurs using the website. In still other instances, the bettor can establish an account with the gambling business, get information from the website, but place the bets using the telephone. There are even "peer to peer" gambling websites, where the website operator does not set the bets, rather the customers set the bets. Internet gambling includes many different types of gambling. The Department's view for some time has been that all forms of Internet gambling, including sports wagering, casino games, and card games, are illegal under federal law. While many of the federal statutes do not use the term "Internet gambling," we believe that their statutory language is sufficient to cover Internet gambling.

As we have noted on several occasions, the Department believes that Internet gambling should remain illegal. Internet gambling poses an unacceptable risk due to the potential for gambling by minors and compulsive gambling. We note that Keith Whyte, Executive Director of the National Council on Problem Gambling, submitted a statement for the record for the April 8, 2007 hearing on Internet gambling held by the House Committee on Financial Services. In this statement for the record, Mr. Whyte stated that "[i]t is likely that individuals with gambling problems will find the internet attractive for pursuing their addiction. Risk factors include underage access, high speed of play, anonymity, social isolation, use of credit/non-cash, 24-hour availability."

Internet gambling carries a potential for fraud and money laundering and the involvement of organized crime in online gambling. For example, a recent indictment brought by the U.S. Attorney's Office in the Southern District of New York charged members of the Uvari group, which included associates of the Gambino Organized Crime Family, with violations of Sections 1084, 1952, and 1955. Section 1084 of Title 18, United States Code, prohibits one engaged in the business of betting or wagering from using a wire communication facility in interstate or foreign commerce to transmit bet or

wagers. Section 1955 prohibits five or more persons from conducting, financing, managing, supervising, directing or owning all or part of an illegal gambling business, which operates in violation of state law. Section 1952 prohibits the use of interstate facilities, interstate travel or use of the mails to either distribute proceeds or to promote, manage, establish, carry on, or facilitate unlawful activity, including a business enterprise involving gambling in violation of state or federal law. The Uvari Group established wagering accounts for their customers with off-site gambling businesses and the customers placed bets on horse races and other sporting events over the Internet and the telephone. Six defendants, including the lead defendants, Gerald Uvari, Cesare Uvari, and Anthony Uvari, pled guilty to a Section 1955 violation. Two pled guilty to Section 1084 violations. Five defendants pled guilty to conspiracy. The case is still pending against two defendants and the case was dismissed against two defendants.

Current Legal Authority and Enforcement Efforts

Legal Authority

As we have stated on previous occasions, the Department interprets existing federal statutes, including 18 U.S.C. §§1084, 1952, and 1955, as pertaining to and prohibiting Internet gambling. These statutes pertain to more than simply sports wagering. As I previously stated, Sections 1084, 1952, and 1955 are the primary federal gambling statutes that are applicable to Internet gambling. Section 1084, which is also known as the Wire Act, prohibits a business of betting or wagering from using a "wire communication facility" in interstate or foreign commerce for the transmission of bets or wagers. It is the Department's view, and that of at least one federal court (the E.D.Mo.), that this statute applies to both sporting events and other forms of gambling, and that it also applies to those who send or receive bets in interstate or foreign commerce, even if it is legal to place or receive bets in both the sending jurisdiction and the receiving jurisdiction. Section 1952 requires the use of "facilities in interstate commerce." Section 1952(b)(1) defines the term "unlawful activity" as including "any business enterprise involving gambling, . . . in violation of the laws of the State in which they are committed or of the United States . . ." Section 1955 is the illegal gambling business statute. Unlike Section 1084, Section 1955 requires that there be a violation of state law. No state's law permits unregulated gambling, whether on the Internet or otherwise. Further, the scope of the gambling activities covered by Section 1955 is broad. Section 1955 (b)(2) provides that the term "'gambling' includes but is not limited to pool-selling, bookmaking, maintaining slot machines, roulette wheels or dice tables, and conducting lotteries, policy, bolita or numbers games, or selling chances therein." The state law does not need to be an Internet specific law. Even statutes such as promotion of gambling statutes may be sufficient as the state law violation.

In October 2006, the Unlawful Internet Gambling Enforcement Act ("UIGEA") was enacted. This statute was codified at 31 U.S.C. §§5361-5367, and it prohibits the acceptance of the specified forms of payments for unlawful Internet gambling by a business of betting or wagering. It is the view of the Department that Internet gambling

was illegal under existing federal criminal statutes even before the UIGEA. Since the enactment of this statute, several Internet gambling businesses have ceased accepting bets and wagers from individuals in the United States. For example, the *Financial Times* reported that PartyGaming quit the U.S. market, causing a 68 percent drop in group revenues.

Unlike other statutes, the UIGEA is specific to Internet gambling. The statute defines the terms “unlawful internet gambling” and “bets or wagers.” However, those definitions are only applicable to that statute. Additionally, the UIGEA does not specify what forms of internet gambling are illegal, but instead relies upon existing federal and state statutes for that purpose.

The UIGEA required the Department of the Treasury and Board of Governors of the Federal Reserve, in consultation with the Attorney General, to issue regulations to implement applicable provisions of the UIGEA. These agencies consulted with the Department during the drafting process. The regulations were published for public comment in the Federal Register on October 4, 2007. As stated in the Federal Register notice, “the proposed rule designates certain payment systems that could be used in connection with unlawful Internet gambling transactions restricted by the [UIGEA]. The proposed rule requires participants in designated payment systems to establish policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit transactions in connection with unlawful Internet gambling. . . . Finally, the proposed rule describes the types of policies and procedures that non-exempt participants in each type of designated payment system may adopt in order to comply with the Act and includes non-exclusive examples of policies and procedures which would be deemed to be reasonably designed to prevent or prohibit unlawful Internet gambling transactions restricted by the Act.” The time period for the public to submit comments on the proposed regulations to the Department of the Treasury or to the Board of Governors of the Federal Reserve ends on December 12, 2007.

Nonetheless, there have been misconceptions that Internet gambling is only now illegal due to the UIGEA. The Department previously supported efforts to amend federal criminal statutes to eliminate any misconceptions concerning their applicability to illegal Internet gambling. We also supported increasing the term of imprisonment for violations of these statutes.

Enforcement Efforts

When the charges against NETeller, an Internet payment company, were announced on January 16, 2007, in the Southern District of New York, FBI Assistant Director Mershon stated that “Internet gambling is a multibillion-dollar industry. A significant portion of that is the illegal handling of Americans’ bets with offshore gaming companies, which amounts to a colossal criminal enterprise masquerading as legitimate business. There is ample indication these defendants knew the American market for their services was illegal. The FBI is adamant about shutting off the flow of illegal cash.” The

Department continues to investigate and prosecute Internet gambling. Currently, the FBI has several pending investigations concerning Internet gambling and the FBI has been the lead agency on several other investigations, which have already led to prosecutions. The FBI coordinates and consults with the Department on issues arising in Internet gambling investigations, particularly on international issues.

Most of the prosecutions brought to date have been the result of joint investigations by federal and state law enforcement agencies. For example, the NETeller prosecution in the Southern District of New York was the result of investigative efforts of the FBI with assistance from the United States Customs & Border Protection, the United States Coast Guard, and the Virgin Islands Police. The prosecution of BetonSports, PLC, which owned several Internet sportsbooks and casinos, in the Eastern District of Missouri was the result of a joint investigation by the FBI and IRS Criminal Investigation with assistance from the Florida Department of Law Enforcement, the Tampa Police Department, the Jacksonville, Florida Sheriff's office, NFL Security, and the NCAA Enforcement Office. The prosecution of Gold Medal Sports, an Internet gambling sportsbook in the Western District of Wisconsin in 2001-2002, was the result of an investigation by the IRS, Criminal Investigative Division, the FBI, United States Postal Inspection Service, and the State of Wisconsin's Department of Justice.

These joint efforts have led to several successful and ongoing prosecutions, the latter of which I cannot comment on beyond the information available in the public record. For example, on July 18, 2007, in the Southern District of New York, the Internet payment company, NETeller, admitted criminal wrongdoing and agreed to forfeit \$136,000,000 for its part in a conspiracy to promote Internet gambling businesses and to operate an unlicensed money transmitting business. The company also agreed to return \$94 million held in the accounts of U.S. customers since January 2007 and will submit to a monitor for a period of 18 months. Two founders of NETeller, Stephen Lawrence and John Lefebvre, who are Canadian citizens, pled guilty to conspiring to promote illegal Internet gambling businesses. They agreed to forfeit \$100 million. In March 2007, three individuals in Maryland were sentenced for running an illegal sports bookmaking operation in Baltimore and Washington, D.C., which used an off-shore wire room in Dominica. These recent successes built upon lessons learned in the U.S. v. Mark Meghrouni, et al. (Paradise Casino) prosecution which convicted two individuals and their corporation in the E.D. of MO in 2000, resulting in \$14+ millions in forfeitures and back taxes, as well as in the U.S. v. Jay Cohen trial in the S.D. of NY in 2000, which produced a conviction and nearly two years imprisonment for a highly-visible proponent of this illegal gambling activity.

Several other cases have been charged and are awaiting trial. In May 2007, seven individuals and four companies were indicted in the District of Utah for operating a business that helped Internet gambling websites disguise credit card charges for gambling as charges for something else, thereby deceiving credit card issuers. The U.S. Attorney's Office in Utah has also filed a civil complaint seeking forfeiture of funds in bank accounts that were used to fund payouts from Internet gambling. In the case of United States v. Arthur Gianelli, et al. in the District of Massachusetts, 13 defendants are

charged with RICO violations alleging a pattern of racketeering activity including gambling violations for an illegal sports betting business. This business operated in Massachusetts with assistance from a toll free number and Internet website, both located in Costa Rica. Similarly, in the Eastern District of Missouri, the grand jury returned a superseding indictment on June 28, 2007, in United States v. BetonSports PLC, et al. BetonSports PLC is a publicly traded company that owns a number of Internet sportsbooks and casinos. In conjunction with the indictment, the United States also filed a civil complaint to obtain a court order requiring BetonSports PLC to stop taking sports bets from the United States and to return money held in wagering accounts. On November 9, 2006, the district court judge signed the order of permanent injunction. On May 24, 2007, the company, BetonSports PLC, pled guilty to the racketeering conspiracy charged in county one of the indictment. The pattern of racketeering to which the company pled guilty included mail and wire fraud, money laundering, and multiple state gambling charges. BetonSports operated out of the Caribbean and Costa Rica and advertised itself as the largest online wagering service in the world. Sentencing is scheduled for June 23, 2008. Lastly, on October 2, 2007, the FBI in Miami-Dade County, Florida, arrested two individuals pursuant to a criminal complaint for a Hobbs Act extortion violation relating to the collection of an internet gambling debt.

In addition to prosecutions, the Department also has reached several settlements concerning Internet gambling. On March 27, 2007, the U.S. Attorney's Office for the Southern District of New York announced that it had entered into a non-prosecution agreement with the Electronic Clearing House, Inc. ("ECHO"), a Nevada corporation involved in the transfer of money on behalf of various on-line payment services, known as e-wallets. In January 2006, the United States Attorney's Office in St. Louis announced a \$7.2 million settlement with the Sporting News to resolve claims that the Sporting News promoted illegal gambling from early 2000 through December 2003 by accepting fees in exchange for advertising illegal gambling.

While the Department has not yet returned indictments alleging violations of the UIGEA, we note that Internet gambling investigations are time and labor intensive cases. The federal indictments that have been returned allege time periods prior to the enactment of the UIGEA. The Department is also handling a challenge to the UIGEA, which was brought by Interactive Media Entertainment and Gaming Association, L.L.C. in the District of New Jersey. In this civil suit, the plaintiff alleges that the UIGEA violates the First Amendment because it impermissibly chills expressive association, violates the Tenth Amendment because it gives to the United States powers reserved to the individual states to regulate gambling and financial transfers, and that it violates a World Trade Organization Dispute Settlement Body ruling. That company is seeking a temporary restraining order to enjoin the enforcement of the UIGEA and its forthcoming regulations. We are awaiting the decision of the court. Similarly, the individual defendants in the BetonSports case have raised the WTO issue. The government's response to the issue has been filed and is publicly available, and we anticipate the Court will find it both accurate and persuasive. Given the ongoing status of that litigation, however, I cannot comment on that issue beyond what has been publicly filed in Court.

Conclusion

On behalf of the Department of Justice, I want to thank you for inviting me to testify today. We thank you for your support over the years and reaffirm our commitment to work with Congress to address the significant issue of Internet gambling. I am happy to answer any questions that you might have.

Mr. CONYERS. Thank you for starting us off.

We welcome now Deputy Assistant Secretary of Treasury Valerie Abend. In her capacity, she serves as advisor to Internet gambling issues, money laundering, identity theft, and other related matters that occur in the course of the duties of the Treasury Department. She was before that been associate director of public policy at the public accounting firm of KPMG.

We welcome you this morning.

TESTIMONY OF THE HONORABLE VALERIE ABEND, DEPUTY ASSISTANT SECRETARY, CRITICAL INFRASTRUCTURE PROTECTION AND COMPLIANCE POLICY, U.S. DEPARTMENT OF THE TREASURY

Ms. ABEND. Thank you.

Mr. Chairman, Ranking Member Smith, and Members of the Committee, it is my privilege to represent the Treasury Department today to discuss the Unlawful Internet Gambling Enforcement Act of 2006.

The act is designed to require the various payment systems to stop the flow of funds from gamblers to businesses providing unlawful Internet gambling services. To accomplish this, the act requires the Treasury Department and the Federal Reserve Board, in consultation with the Justice Department, to jointly prescribe regulations requiring participants in designated payment systems to establish policies and procedures that are reasonably designed to prevent or prohibit such funding flows.

On October 4, 2007, the Treasury Department and the Federal Reserve Board published a notice of proposed rulemaking seeking public comment on the proposed rule. Our goal when writing this proposed rule was to faithfully adhere to the mandate set forth by Congress in the act.

We have learned a lot since the passage of the statute by working with both the Federal Reserve Board and the Justice Department. Payment systems are complex and vary greatly. They are built to meet the needs of particular participants, and while some are modernized, others are paper-based systems. The complexity and differences necessitate different approaches to meet the requirements of the statute effectively. We expect to learn more from the comments that we will receive during the comment period, which extends through December 12, 2007.

As I mentioned earlier, our overarching principle has been that the proposed rule should faithfully adhere to the congressional mandate in the act. First, the act requires us to designate payment systems that could be used in connection with unlawful Internet gambling. The proposed rule designates the following five payment systems: automated clearinghouse systems; card systems, including credit cards, as well as stored value cards; check collection systems; money transmitting systems; and wire transfer systems.

Second, the act requires us to provide exemptions if the Treasury Department and the Federal Reserve Board jointly determine that it is not reasonably practical for participants in designated payment systems to prevent or prohibit unlawful Internet gambling transactions. No payment system is exempted completely from this proposed regulation.

However, the proposed rule does partially exempt certain participants within some of the designated payment systems from having to establish policies and procedures. The Treasury and the Federal Reserve Board determined that this was the most appropriate way to implement the act consistent with congressional intent.

Under the proposed rule, the gambling business's bank, or if abroad, the first U.S. bank dealing with that bank, is not exempted because it could through reasonable due diligence ascertain the nature of its customer's business and ensure that the customer relationship is not used to receive unlawful Internet gambling transactions. Let me emphasize that there are requirements under the proposed rule for the bank in the United States that has a corresponding relationship with a gambling business's bank. The proposed exemptions generally extend to the gambler's bank.

Third, the act requires us to provide nonexclusive examples of policies and procedures which would be deemed "reasonably designed" to prevent or prohibit unlawful Internet gambling transactions. As a result, this proposed rule contains a "safe harbor" provision, as mandated by the act, that includes for each designated payment system nonexclusive examples of reasonably designed policies and procedures.

Fourth, the act requires us to ensure that certain transactions excluded from the definition of the term "unlawful Internet gambling" are not prevented or prohibited by the proposed rule.

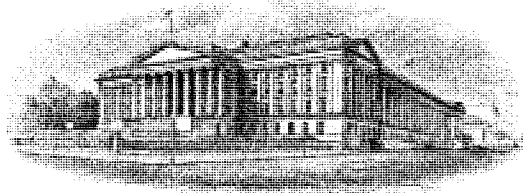
Through our efforts to date, we are making great progress in reaching our objective of promulgating a final rule that strictly adheres to the statute. We expect to receive a large number of comments as we approach the close of the comment period. We have an open mind on all aspects of the proposed rule.

We will be providing analysis of the comments received, and reasons for any decisions that will be made, as we publish the final rule. Let me assure you that we are committed to giving fair consideration to all relevant comments as we work toward promulgating a final rule. We have much work to do, but we understand the task ahead and what we will need to do to reach our objective.

Thank you very much for your time. I would be happy to answer any of your questions.

[The prepared statement of Ms. Abend follows:]

PREPARED STATEMENT OF VALERIE ABEND



U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 10:00 a.m. (EST), November 14, 2007
CONTACT Jennifer Zuccarelli, (202) 622-8657

**DEPUTY ASSISTANT SECRETARY VALERIE ABEND
BEFORE THE U.S. HOUSE OF REPRESENTATIVE JUDICIARY COMMITTEE**

WASHINGTON- Mr. Chairman, Ranking Member Smith, and Members of the Committee, it is my privilege to represent the Treasury Department today to discuss the Unlawful Internet Gambling Enforcement Act of 2006 (the "Act").

Proposed Rulemaking Process

The Act is designed to require the various payment systems to stop the flow of funds from gamblers to businesses providing unlawful Internet gambling services. To accomplish this, the Act requires the Treasury Department and the Federal Reserve Board, in consultation with the Justice Department, to jointly prescribe regulations requiring participants in designated payment systems to establish policies and procedures that are reasonably designed to prevent or prohibit such funding flows.

On October 4, 2007 the Treasury Department and the Federal Reserve Board published a Notice of Proposed Rulemaking seeking public comment on the proposed rule. Our goal when writing this proposed rule was to faithfully adhere to the mandates set forth by Congress in the Act.

I would like to take a moment to discuss the process the Treasury Department followed to develop this proposed rule. As you are aware, joint rule making requires extensive coordination. The Treasury and the Federal Reserve Board began this proposed rulemaking first by identifying individuals within our offices that have experience with rulemaking and payment systems' operations. At the Federal Reserve, this included individuals responsible for FedWire, one of the largest payment systems in the country.

We have learned a lot since the passage of the statute by working with both the Federal Reserve Board and the Justice Department. Payment systems are complex and vary greatly. They are built to meet the needs of the particular participants and while some are modernized, others are paper-based systems. The complexity and differences necessitate different approaches to meet the requirements of the statute effectively. We expect to learn more from the comments that we will receive during the comment period, which runs through December 12, 2007.

Fulfilling the Act's Mandates

As I mentioned earlier, our overarching principle has been that the proposed rule should faithfully adhere to the Congressional mandates in the Act. First, the Act requires us to designate payment

systems that could be used in connection with unlawful Internet gambling. The proposed rule designates the following 5 payment systems:

- Automated Clearing House Systems
- Card Systems (e.g., credit cards, as well as stored value cards)
- Check Collection Systems
- Money Transmitting Businesses
- Wire Transfer Systems (i.e., CHIPS)

Second, the Act requires us to provide exemptions if the Treasury Department and the Federal Reserve jointly determine that it is not reasonably practical for participants in designated payment systems to prevent or prohibit unlawful Internet gambling transactions. No payment system is exempted completely from this proposed regulation. However, the proposed rule does partially exempt certain participants within some of the designated payment systems from having to establish policies and procedures. The Treasury and the Federal Reserve Board determined that this was the most appropriate way to implement the Act consistent with Congressional intent.

Under the proposed rule, the gambling *business's* bank, or, if abroad, the first U.S. bank dealing with that bank, is not exempted because it could, through reasonable due diligence, ascertain the nature of its customer's business and ensure that the customer relationship is not used to receive unlawful Internet gambling transactions. Let me emphasize that there are requirements under the proposed rule for the bank in the United States that has a corresponding relationship with a gambling business's bank. The proposed exemptions generally extend to the gambler's bank. For example, in the case of checks, the check collection system is highly automated and it is not reasonably practical for the gambler's bank to know whether a check presented to it for payment involves unlawful Internet gambling. However, the gambling business's bank, or, if abroad, the first U.S. bank to receive the check under the proposed rule would need to have policies and procedures to block the processing of the check.

Third, the Act requires us to provide nonexclusive examples of policies and procedures, which would be deemed "reasonably designed" to prevent or prohibit unlawful Internet gambling transactions. As a result, this proposed rule contains a "safe harbor" provision, as mandated by the Act that includes for each designated payment system nonexclusive examples of reasonably designed policies and procedures.

Fourth, the Act requires us to ensure that certain transactions excluded from the definition of the term "unlawful Internet gambling" are not prevented or prohibited by the proposed rule. For example, the UIGEA states that "the term 'unlawful internet gambling' shall not include any activity that is allowed under the Interstate Horseracing Act of 1978 (IHA). This provision was immediately followed by the Sense of Congress provision that states that the UIGEA was not intended to change the relationship between the IHA and other federal statutes. The IHA did not amend or repeal existing criminal statutes. Since the proposed rule only covers "unlawful internet gambling", it in no way requires participants to prevent or prohibit transactions that are lawful under the Interstate Horseracing Act and all other applicable federal statutes.

Conclusion

Through our efforts to date, we are making progress in reaching our objective of promulgating a final rule that strictly adheres to the statute. We expect to receive a large number of comments as we approach the close of the comment period. We have an open mind on all aspects of the proposed rule. We will be providing analysis of the comments received, and reasons for any decisions that will be made, as we publish the final rule. Let me assure you that we are committed to giving fair consideration to all relevant comments as we work toward promulgating a final rule. We have much work to do, but we understand the task ahead and what we will need to do to reach our objective. Thank you, I would be happy to answer your questions.

Mr. CONYERS. Thank you very much.

Welcome, Professor Weiler. We are delighted to have you here today. We introduce you as a professor of law at the New York University School of Law. You have specialized in international law for quite a while and taught at both Harvard School and the University of Michigan Law School. You have had a lot of contact with the World Trade Organization.

We would like to get your perspective on Internet gambling this morning, and we are glad that you are before us today.

TESTIMONY OF JOSEPH H.H. WEILER, PROFESSOR AND DIRECTOR, JEAN MONNET CENTER FOR INTERNATIONAL AND REGIONAL ECONOMIC LAW & JUSTICE, NEW YORK UNIVERSITY, SCHOOL OF LAW

Mr. WEILER. Thank you, Chairman Conyers and Members of the Committee for inviting me to be here today. This is the first time I have testified before a congressional Committee, so I apologize in advance if inadvertently I do something that goes against the conventions.

My name is Joseph Weiler.

Mr. CONYERS. We have our people standing out by the door in case you make a mistake of any magnitude. [Laughter.]

Mr. WEILER. I have already prepared my neck. [Laughter.]

My name is Joseph Weiler. I am married. I have five children. I want to say at the outset that I express no views on gambling, remote Internet gambling, or any other form of gambling. My testimony is only as regards the compliance of the United States with its international legal obligations and the rule of law.

The WTO is the central world organization which regulates trade. The United States is a founding and prominent member, the prominent member. Under the rules of the WTO, contrary to some myth, a State is not obliged to accept any services from outside. It is not obliged to accept any goods from outside. It is entirely up to them whether or not to give a commitment. Once a State gives a commitment, it is expected that it will follow it because other economies and other individuals base their commercial activities on that commitment.

The United States gave a commitment which has been interpreted authoritatively on three distinct occasions as covering remote gambling. The United States contested that before the WTO. It lost before a panel. It lost before the appellate body, which is, if you want, the World Trade Court, and it lost again before a compliance panel. There is simply no question in anybody's mind that the ban on remote gambling coming from other members of the WTO is in violation of the United States's international legal obligations.

The United States also claimed in those proceedings that there were serious public policy reasons why remote Internet gambling should be banned. The WTO did not reject in principle that type of justification, but said that it had to be across-the-board, and yet it found on three distinct occasions that the United States was discriminating, that what it was banning for outside providers was in fact allowed legally within the United States, so that it gave in that organization the distinct impression that this was in some re-

spect protectionism, not protecting consumers, but protecting special remote gambling interests within the United States.

I repeat: the WTO does not oblige the United States to have remote gambling. What it does not allow is to pick and choose, to have legalized remote gambling within the United States, and to ban it when it comes from outside partners to whom the United States gave a commitment.

The reaction to this ruling by the WTO has been curious, to use a neutral word, in two respects. First of all, despite the fact of this clear and egregious and unambiguous illegality, the United States, or I should say the executive branch of the United States, continues to indict, prosecute and threaten indictment of corporations and individuals who are exercising a commercial activity which the United States guaranteed to its partners would be available to them. They are doing that under the shield of the Uruguay Round Agreement Act which in the opinion of the executive branch allows them to do that despite the abject illegality at the international level.

And secondly, the United States has announced that it will withdraw its commitment in respect of remote betting. My view is that these two reactions are damaging to the United States. Being a law professor, I will explain the first with a hypothetical. Imagine another country, say India, gave a commitment to the United States in respect of supply of medical services. On the basis of that, American corporations and doctors set up a hospital and a medical facility, invested and practiced and offered their services. And then this country in violation of that commitment one day announced this can no longer take place.

We would be outraged. They would lose all the investment. Imagine further, not only did they suddenly pull the rug from that commitment, but they prosecuted the doctors, the administrators, the nurses which were offering these medical services, and put them in prison. We would be doubly outraged. And if they said even though we acknowledge the international legal violation, we are still going to prosecute these individuals.

We would be most outraged, Mr. Chairman and Members of the Committee, if then they turned around and said, and in doing that, we are simply following the example of the United States in the gambling case. The United States is the world leader in trade matters, and it leads by example. This is not a good example in which we should conduct our trade policy.

The second reason is that if our economy is increasingly a service-oriented economy, and increasingly directed to exports; if today it is the only instance to my knowledge in which in the face of an adverse ruling of the world body to which the United States agreed to give unconditional compliance, that the country is withdrawing its commitment. It would be detrimental to the interests of the United States in the future when other countries, when we win the case, their response is to withdraw the commitment.

Finally and lastly, Mr. Chairman, the statements of the executive branch are putting the responsibility on you, on the Congress. They are saying we are doing this on behalf of the Congress of the United States. That is how we were instructed to conduct this busi-

ness when the Uruguay Round Agreement Act was passed. I do not think this is wise.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Weiler follows:]

PREPARED STATEMENT OF JOSEPH H. H. WEILER

Full Written Statement by Professor Weiler

I want to thank Chairman Conyers and the members of the committee for inviting me to be here today.

My name is Joseph Weiler. Since 2001 I have served as Professor of Law and Director of the Jean Monnet Center for International and Regional Economic Law & Justice at NYU School of Law. Prior to that, from 1992 till 2001, I was Manley Hudson Professor of International Law at Harvard Law School and before that a Professor at the Michigan School of Law.

One area of my expertise is the law of the World Trade Organization. I have served on occasion as a WTO Panel Member. I attach to this Statement a full resume.

Recently I have been retained, and continue to be retained, by several Law Firms whose clients include individuals and corporations who have been indicted or are threatened by the US under the Wire Act and other related acts for offering remote internet betting services from outside the United States. I was asked to provide them with expert advice on, *inter alia*, the compatibility of such indictments with US international legal obligations and more generally with the compatibility of the overall US ban on remote betting from providers located outside the US in countries which are Member States of the WTO.

In my testimony to Congress today I want to summarize my principal conclusions and recommendations.

1. The United States is a founding Member of the GATT, and a Founding and prominent Member of the WTO. One of the Agreements which come under the umbrella of the WTO is the GATS – The General Agreement on Trade in Services, under which a Member such as the United States *may* if it so wishes, open certain economic sectors to service providers from other Members. The incentive for a Member such as the US to open up such sectors is self-interest: It is part of complex negotiations whereby other Countries may offer

similar commitments in respect of US service providers. Additionally, opening up internal services to outside providers may be considered in the interest of US Consumers – offering them more choice and enhancing competition which produce efficiency and lower prices. A country is not obliged to give such commitments but once it does it is obliged to respect them – since other countries’ adjust their economies in view of such commitments and individual corporations and investors will gear their economic activities based on such commitments and promise of access.

2. The United States voluntarily gave a legally binding Commitment in respect of “*Recreational, Culture and Sporting Services*” which have been held to include gambling and betting services.

3. Notwithstanding its clear international obligation to offer access to the thriving remote betting industry within the United States to providers from other WTO Members, the United States has used the Wire Act and other related Acts criminally to indict and even convict individuals and corporations and effectively to shut out all such access to outside providers.

4. Antigua brought a case against the US in the WTO challenging the legality of the US conduct. The United States sought to defend the legality of its conduct before all judicial instances of the WTO. It has lost, comprehensively, in all such proceedings. Its conduct was held to be illegal by a WTO Panel, the WTO Appellate Body (the supreme judicial instance of the WTO) and a subsequent Compliance Panel.

5. In face of such conclusive holding of illegality the US has decided not to appeal the final decision of the Compliance Panel. Instead the US has taken steps to withdraw its GATS commitment in this area. This might be regarded and is regarded by many as a cynical manipulation of the system – you lose the game, so you try and change the rules. It also charts a way and creates a political precedent which might harm US interests when other countries emulate such behavior. Be that as it may, it constitutes a ringing admission by the United States of the illegality of its actions to date.

6. And yet, the US Executive Branch persists in maintaining indictments and threatening indictments that are based on internationally tainted Acts and conduct. In what is in my view a particularly astonishing approach, the Executive Branch is persisting in a policy which includes prosecutions against individuals the legality of whose activities were covered and guaranteed by the international legal obligations of the United States, and is simply seeking to defend itself by relying on the ground that its illegal actions are shielded by the Uruguay Round Implementing Act from suits by individuals in domestic US courts. The approach of the Executive Branch amounts to the following: 'What we are doing may be illegal under international law, but you, the individuals cannot do anything about it, because under our reading of the Uruguay Round Agreement Act we are immune.' Even if the URAA gave such immunity to the Executive Branch – which I do not believe to be the case – this approach amounts to a spectacular contempt to the rule of international law and to American notions of fairness and justice.

7. Let me now dispel some misunderstandings surrounding this saga. The WTO regime (of which the United States is one of the principal architects) is often depicted as encroaching on US "sovereignty" and internal autonomy in an unacceptable way. What, it is sometimes asked, if the United States came to the conclusion that, say, Internet betting posed specific risks to consumers which require regulation or even banning of such forms of betting?

Does the WTO prohibit the US from taking action to protect against such risks? The answer is a resounding no. If such risks exist the US would have full legal authority under the GATS to regulate the industry to protect it against such risks. If it considered it wise it could even impose a ban. But what it cannot do is to regulate or ban in a discriminatory manner. Under its WTO obligations it cannot regulate or ban in a manner which slyly supports and allows domestic providers of remote betting but, for example, bans suppliers from WTO partners. All legal instances in the WTO found that this is exactly what the US is doing today. The WTO found, that whereas the US was trying to justify its ban on outside providers of remote betting services by considerations of public policy and public order it allowed at the very same time within the USA the operation of

“... substantial and even prominent businesses, with, collectively, thousands of employees and apparently tens of thousands of clients, paying taxes or generating revenue for government owners, having traded openly for up to 30 years and in some cases even operating television channels.... The evidence regarding the suppliers demonstrates the existence of a flourishing remote account wagering industry on horse racing in the United States operating in ostensible legality.”

The conduct of the Executive Branch in banning outside providers is not just discriminatory and thus in violation of the WTO, but one cannot escape the suspicion that it might be motivated in part by a protection of special interests within the United States rather than protection of consumers.

8. The conduct of the Executive Branch is harmful to the United States in many ways.

- Our economy relies more on more on a robust exporting sector – both in goods and services. The WTO including the GATT and GATS are the principal legal framework which guarantees US businesses a discrimination-free environment in which to sell their products and services in other WTO countries. Imagine that a foreign country took a commitment which, say, allowed American hospitals and doctors access to offer medical services. Imagine further that based on that commitment the US hospitals and doctors began offering services in a WTO Member. Imagine now that this country failed to live up to its commitment and imprisoned American doctors on the ground that a national law forbade the offering of such services to doctors not trained in the host country. We would be rightly outraged. We would be even more outraged if that country turned to the American doctors and said: though we acknowledge that our actions are in violation of our agreement, according to our internal law, you have no recourse. You sit in jail. But what would we say if that country turned around and said – We are only following the example of the United States of America. Our outrage would at this point turn not against such a country but against our own Executive Branch.

- We should be equally concerned by the move of the Executive Branch to withdraw its commitment. What it should do is to bring our law and conduct into compliance with our international legal obligations on which many countries and individuals have relied rather than try to renege on its promises. This is not simply or even primarily a moralistic point. Our country is the trendsetter and leader in so many international arenas. Whether we like it or not, *we lead by example*. As our economy moves increasingly towards a high tech, knowledge based service oriented model and as we realize that our future prosperity will depend increasingly of tapping into export markets, notably the huge emerging markets such as China and India, is it really in our self interest to teach this particular example? When you are caught denying access or discriminating against American businesses in violation of your GATS or GATT obligations, rather than complying, simply withdraw your commitment and change your promise?
- The United States justly used to enjoy a world reputation as a champion of liberty, rights and the rule of law. I think it is acknowledged by all political forces that in recent times this reputation has been seriously diminished compromising American leadership and American interests. In some areas, notably in the area of the war on terror and national security, there might be a feeling that existing rules of international law compromise the ability of the United States effectively to defend itself. I make no pronouncement on that. But if this is the case, it would seem to me that in all other areas, where national security is not involved, this country would be well served if its Executive Branch was particularly vigilant and scrupulous in observing the rule of law, which includes a respect for international legal obligations. This is, too, in the interest of the United States. It should be recalled that United States signed and supported the WTO Dispute Resolution Understanding which provides, *inter alia*, in Article 17.14

An Appellate Body report shall be adopted by the DSB and *unconditionally accepted by the parties to the dispute* unless the DSB decides by consensus not to

adopt the Appellate Body report within 30 days following its circulation to the Members.” (Emphasis added.)

Article 21.1 of the DSU provides in turn:

Prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members

It should also be recalled that the United States is often on the winning side of trade disputes, and when it is on the winning side it insists vigorously that its trading partners faithfully comply with their legal obligations.

To give but one example: In its famous dispute with the European Union as regards exportation of Meat Hormones, the US won its case. Here are the words of the representative of the US in the WTO:

The representative of the United States said that this was an important juncture in the dispute settlement process. Her delegation welcomed the [European Union's] statement. It was important for the integrity and viability of the dispute settlement mechanism that Members complied with the DSB's recommendations. In this case, the Communities' obligations were clear. In accordance with the rulings, the ban had not been supported by scientific evidence nor by any of the risk assessments presented during the proceedings. All the risk assessments that had been conducted had proved that the six hormones in question were safe. This meant that compliance with the DSB's recommendations required the Communities to remove the ban on the importation of meat produced with the use of any of the six hormones to promote growth.

The matter this Committee is considering is not about National Security; the US Executive Branch is the custodian of the United States national interest. It is not in American interest

to weaken the ability of the United States to insist on prompt compliance with WTO rulings by others.

- When a Member fails to comply with a decision of the WTO Appellate Body and Dispute Settlement Body, it opens itself to trade sanctions by the winning country in the form of withdrawal of concessions. This has been interpreted by some to suggest that as long as the US was willing to submit itself to such sanctions, it was discharging its obligations under the WTO system. This is an utter misconception of the system. The withdrawal of concessions is meant to be a sanction and incentive for a recalcitrant Member to fulfill its obligation, not an indulgence you buy to expiate your wrong doing. To argue otherwise would be the equivalent of a rich man claiming that as long he was willing to pay the fine, he was under no legal obligation to move the car he parked in front of a fire hydrant.

9. This Committee is not a court of law so I will spare it a lengthy legal analysis concerning the question whether or not individuals may rely in their defense against the indictments brought against them on the fact that the Acts on which such indictments have been brought have been found to be in violation of the US legal obligations when applied to individuals supplying remote betting services from other WTO Members. Some language in the Uruguay Round Agreement Act notwithstanding I think there are weighty legal arguments that individuals should not be denied, *in defending themselves*, the ability to argue that Congress did not intend in approving US participation in the WTO, that prosecutorial discretion should be exercised in a manner which would bring the United States into violation of its international legal obligations. There is, however, one crucial point which should be of interest to this Committee. In many of its utterances the Executive Branch has taken the position that it is defending the “sovereignty” of the United States as a whole, and that in its conduct in this matter it is executing the will of Congress. I respectfully and vigorously dispute both these propositions. When a country solemnly adopts an international legal obligation and then honors that obligation it does not compromise its sovereignty – it manifests its sovereignty. For generations the United States has taken the view that all Congressional Acts should, if at all possible, be interpreted and applied in such a way as to respect international obligations solemnly

undertaken by this Country. This is called the Charming Betsy doctrine. We expect the same from all other countries. It is possible to interpret both the Uruguay Round Agreement Act (taking the US into the WTO) and the Statutes under which the Executive Branch is seeking to ban remote betting from service suppliers located in our WTO partners, in a manner which would respect American international legal obligation and commitment to the rule of law. The Executive Branch is doing no service to the US by violating these obligations, and laying the responsibility at the feet of Congress. Congress should not allow such.

10. As I indicated above, it is clear that remote betting over the internet does pose various legitimate concerns. There are potential hazards to, for example, consumers which do not exist in on-site gambling. If the United States were to adopt a "prohibition mentality" the WTO would not prevent the US from banning all such betting, provided such a ban could be justified on grounds of public policy and public morality and was applicable to *all* remote betting, internal and external. I do not think such a total ban is either wise or likely. The alternative is to adopt a regulatory regime which would address the hazards of remote betting and would apply with no discrimination both to domestic and foreign service providers from our WTO partners. In this way the US would both address its legitimate social concerns and respect its international legal obligations.

Mr. CONYERS. We appreciate very much your testimony here today. There will be a number of questions following.

We are now joined by Ms. Annie Duke, a graduate from Columbia University where she double-majored in English and psychology. That later held her in good stead as she went on to become the holder of the women's record for the most in-the-money finishes in the World Series of Poker. She has helped tutor and train many people in the skill of poker, none of which are Members of the Judiciary Committee of which you are before now.

Welcome.

**TESTIMONY OF ANNIE DUKE, ON BEHALF OF THE
POKER PLAYERS ALLIANCE, LOS ANGELES, CA**

Ms. DUKE. Thank you, Chairman Conyers and Members of the Committee, and thank you for giving me the opportunity to testify today. I am testifying as a representative of the 800,000 members of the Poker Players Alliance, but also as an American citizen who is keenly interested in the issues of personal freedom and responsibility.

I am a mother of four young children ages 12, 9, 7, and 5. As Chairman Conyers pointed out, I attended Columbia University for my BA and then went on to pursue my Ph.D. in cognitive psychology at the University of Pennsylvania. From there, I chose not to go into academics, but in 1994 I used my education to become a professional poker player, which I am sure the National Science Foundation which gave me the grant to go to graduate school, is quite happy about. [Laughter.]

But I did excel at my profession, becoming the leading female money-winner in the history of the game, and I have supported my four young children for 13 years on my poker winnings.

Mr. CONYERS. Can some of the Committee Members join in your classes?

Ms. DUKE. Absolutely. I actually just gave a class last weekend, is what I was doing. And I do do private tutoring if anybody's interested.

So for me, obviously, the freedom to play poker is an extremely important one, and the freedom to play where and when I want is extremely important. So the basic issue for me is personal freedom, the right to do what I want in the privacy of my own home.

As part of the wonderful core curriculum at Columbia University, I was compelled to read John Locke and John Stuart Mill. They were the first to put forward the idea that except where one is doing direct harm to others, the government should not direct the activities of the people. Madison and Jefferson enshrined this idea in our country's founding documents. It is my opinion that Congress strayed significantly from these founding principles in passing the Unlawful Internet Gaming Enforcement Act in the late and closing hours of the legislative session in 2006.

Now, some of you may believe that gaming is immoral or unproductive. I certainly respect your beliefs. I absolutely respect your opinion, and I respect your choice not to engage in those activities if they are against your moral code. What I do not respect, though, is that they should seek to have government prevent others from engaging in those activities. Ronald Reagan said, "I believe in a

government that protects us from each other. I don't believe in a government that protects us from ourselves." I believe that the UIGEA is in violation of Mr. Reagan's words.

Prohibitionists site compulsive gambling as one of the reasons that they want to prohibit gaming. The Committee has received a study from Dr. Howard Schaffer of Harvard Medical School to the effect that the incidence of problem gambling is less than 1 percent, and the U.K. gambling study which was just completed confirms that. So I am not going to speak to that.

But if the government is going to ban every activity that can lead to compulsion, they are going to have to ban nearly every activity—shopping, day-trading, sex, chocolate, even water-drinking can lead to compulsion. I am aware of one person who died from an addiction to water. Like gambling, compulsive shopping happens to a very small percentage of the population, and yet we don't seek to ban it. In terms of costs to society, the damage caused by problem gambling is far less than that of alcohol, tobacco, fatty foods, sugary soft drinks, or any other number of things that the government does not seek to ban.

Prohibitionists also point to the possibility of children playing online as a justification to ban it. Now, Mr. Colopy, my colleague on the witness panel, will show technology designed to prevent children from getting on the Internet to gamble, and will speak to the regulatory programs in the U.K. and elsewhere that work well, so I won't speak to those in particular.

But as a mom of four children ages 12, 9, 7 and 5, I would like to say that in my opinion whether children gamble online is primarily a parent's responsibility, and it is their responsibility to know what their children are doing on the Internet, make sure they are not stealing their credit card, and make sure that they have control of what is happening in their household.

Frankly, if a child is gambling behind their parents' back and stealing their credit cards, I imagine that online gambling isn't really the problem there and there are larger issues in that family. But I do believe that if I do choose to enforce those rules in my household, that we should have good government policy to support my rules.

The UIGEA is not that good government policy. In the closing hours of the last Congress, Senator Bill Frist slipped the UIGEA into the port security bill. The UIGEA essentially deputizes financial institutions and makes them function as the Internet morality police. The Internet gambling laws that we have right now are a hodge-podge of antiquated laws, most of which don't even contemplate the Internet. The governing Federal statute, the Wire Act of 1961, has been interpreted by the Fifth Circuit Court to only apply to sports betting, and not other forms of gambling like poker, and few States actually have laws that speak directly to Internet wagering.

In the proposed rule, the Treasury and the Fed make clear that they do not intend to clarify what unlawful Internet gambling means. In other words, they are going to create a crime, but they are not going to tell anyone what the crime is. The regulators say that it would be too difficult for them to go through the laws of each and every State with respect to every form of gambling and

ascertain what is or isn't legal in each State. And yet that is exactly what they are requiring the general counsel of each and every bank to do.

This is no way to make regulatory law, and in my opinion, not good government policy. Instead, the Poker Players Association supports Representative Frank's legislation to create a Federal licensing and regulation system for Internet gaming where States can opt in or out of any or all forms of gaming.

We also support Representative McDermott's bill to impose a small tax on Internet gaming deposits, which would yield billions of dollars for Federal and State governments. We also support Representative Wexler's bill to clarify that poker, bridge, mahjong, backgammon, and other games of skill are outside the ambit of the Federal gambling statutes, provided they have adequate protections against minors and compulsive gamblers.

The Poker Players Association also supports Representative Berkley's bill to study the issues with Internet gambling. Although we believe there is adequate information available today, we believe that additional study will only make it more clear that licensing and regulation is always better than prohibition.

In closing, though, I do want to go back to what I originally said, that this for me is an issue of personal freedom and civil liberties. Again, I would like to thank you for the opportunity to testify today.

[The prepared statement of Ms. Duke follows:]

PREPARED STATEMENT OF ANNIE DUKE



TESTIMONY OF ANNIE DUKE

on behalf of

THE POKER PLAYERS ALLIANCE

HOUSE COMMITTEE ON THE JUDICIARY

**“Establishing Consistent Enforcement Policies
in the Context of Internet Wagers”**

November 14, 2007

Chairman Conyers and members of the Committee, I would like to thank you for the opportunity to testify before your committee. I am doing so as an American citizen who is concerned about personal freedom and personal responsibility. I am also here to express the views of the nearly 800,000 Americans who belong to the Poker Players Alliance.

As a mother of four who supports her family as a professional poker player, I have a personal interest in the outcome of these hearings. I have excelled at my chosen profession, not only supporting my family for 13 years from poker earnings but also becoming the highest female money winner in tournament poker history over those 13 years. Having the right to continue to pursue my profession, wherever I might choose to pursue it, is very important to me from both a financial standpoint but also from the broader perspective of freedom, personal responsibility and civil liberties.

At its most basic level, the issue before this committee is personal freedom -- the right of individual Americans to do what they want in the privacy of their homes without the intrusion of the government. From the writings of John Locke and John Stuart Mill, through their application by Jefferson and Madison, this country was among the first to embrace the idea that there should be distinct limits on the ability of the government to control or direct the private affairs of its citizens. More than any other value, America is supposed to be about freedom. Except where one's actions directly and necessarily harm another person's life, liberty or property, government in America is supposed to leave the citizenry alone. Examples of Congress straying from this principle are legion, but few are as egregious as The Unlawful Internet Gambling Enforcement Act of 2006, or UIGEA.

To be sure, there are many who believe that gaming is immoral or unproductive. I don't share these beliefs, but I do respect them. What is harder to respect is the idea that just because someone disapproves of a particular activity, that they would seek to have the government prevent others from engaging in it.

Of course, opponents of gaming will cite the incidence of compulsive gambling and the possible exposure of minors as reasons to prohibit it. With respect to compulsive gambling, this

committee has received expert testimony confirming what most academic studies on compulsive gambling have found: that the incidence of problem gambling in the population of adults who engage in gambling activity is less than 1%. From a similar study in the United Kingdom, we know that the availability of betting over the Internet does not increase it over time. Furthermore, even if one's primary concern were the very small incidence of compulsive gambling, then licensing and regulation offer more effective and less intrusive means to combat it.

Frankly, if the government is going to ban every activity that can lead to harmful compulsion, the government is going to have to ban nearly every activity. Shopping, day trading, sex, chocolate, even drinking water -- these and myriad other activities, most of which are a part of everyday life, have been linked to harmful compulsions. Are we going to move inexorably toward a world where we prohibit online shopping because some people compulsively spend themselves into bankruptcy? Worse, are we going to ask banking institutions to monitor and regulate our citizens' online shopping behavior to determine when a purchase can or cannot be approved? Gambling, like shopping, is the subject of compulsion in a very small percentage of the population -- less than one-tenth the number of people who have trouble with alcohol. In terms of the damage to society, problem gambling is orders of magnitude smaller than tobacco, alcohol, fatty foods, sugary soft drinks, and a great many other things that the government does not seek to prohibit. And, let us again remember that compulsive gambling occurs in less than 1% of the population, and that the availability of Internet gaming does not increase that percentage.

Of course, prohibitionists point to the possibility of children betting online as the other justification for prohibiting it. In fact, most people who seek to restrict individual freedom invoke protection of children as their motivation. I suspect they find that that argument has more resonance than what is often their real motivation -- to treat adults like children, and manage their choices for them.

The reality is it is very hard for a child to lose money gambling on-line -- one needs to either have a credit card or a checking account to do so -- cash cannot be used. The concern many

point to is a child using their parent's credit card to sneak online and gamble. First of all, in that scenario, the parent will nearly always decline the charge -- and successfully. For that reason, Internet gaming sites have a large incentive to ensure that their players are who they say they are, and that they are of age, in order to avoid expensive charge-backs. Furthermore, presumably the first time the parent sees an Internet gambling charge on their statements, one would hope that at minimum a very serious chat would ensue with the child. As a mother of four, however, I feel the need to make this point: if a child is stealing a parent's credit card and gambling on-line, that family probably has much more serious issues than Internet gambling. I monitor my children's online activity, and, frankly, that is my job, not my government's. Of all the things I and other parents worry about happening to our children on line, gambling is pretty far down on the list.

Still, if one's primary concern is preventing minors from betting on-line, as opposed to preventing adults from doing so, then licensing and regulation again provides a more effective and less intrusive solution than prohibition. We will hear other expert testimony demonstrating that there are highly effective identity and majority verification technologies available.

Again, though, I have to express my skepticism that that concerns about children are really what is driving this debate. By that, I mean that I doubt that there is anyone who is opposed to Internet gaming because of children who wouldn't still be opposed to Internet gaming for adults, even if it could be proven to them that children can be protected. However, if there are such people on this Committee, or in Congress, I would urge them to look at the regulatory systems being set up in the U.K. and other European nations, as they are highly effective. To reiterate: if your concern in this matter is about children, there are solutions available. If, instead your interest is in treating adults like children, then there are not.

What is remarkable to me about the UIGEA is that while it allows games of pure luck, like the lottery, it prohibits a game of skill like poker. For nearly 200 years U.S. presidents, generals, members of Congress, Supreme Court Justices and average citizens have enjoyed the challenge and the fun that is poker. I have no doubt that tonight, somewhere not too far from the U.S. Capitol, groups of friends and family will open a deck of cards and play some poker. This scenario will be replicated in almost every city across the U.S. That is because poker is an

American pastime, it is woven into the very fabric of American history. Poker typifies Americana just like baseball or Jazz and has become a positive ambassador of American culture throughout the world.

Surveys have shown that more than 70 million Americans play poker at least once in a while. And, within the past several years, an estimated 23 million Americans have begun playing with people from all over the world via the Internet. Remarkably, though, some in Congress have insisted that when you put the word "Internet" in front of poker, this American tradition and the people who play it become suspect. I don't believe that the government should be preventing consenting adults from enjoying poker just because it has moved from the kitchen table to the computer table.

Poker is a great egalitarian game. Anyone who is willing to learn, regardless of race, creed, color or gender, can succeed at poker. And playing on the Internet gives millions of Americans the freedom to enjoy the game in the comfort of their homes, when it would be otherwise impossible to get to a casino, or gather others to play in person. As a mother of four young children, I don't have the liberty of being away from home every day or at night when my children return home from school. The ability to play on the Internet allows me more time with my family.

But my situation only represents a small section of the online poker playing community. Each day the Poker Players Alliance receives emails from its members detailing why Internet poker is important to them. Many of these emails detail a person's physical disability and why they are unable to get to a casino, and in some cases suffer from muscular diseases which do not allow them to hold cards or poker chips and the virtual game is the only way for them to play. Other emails describe how they are caring for sick loved ones who are home-bound or bed ridden and the few hours they get to play poker in the comfort of their home is their escape from the monotony of their day. There are countless stories, of every day law-abiding Americans who play Internet poker, and for whom the proposed ban on poker would have tragic unintended consequences.

The vast majority of Internet poker players are doing so for recreation and entertainment. On average, a person spends \$10 a week playing online poker. 10 dollars! You can't even get a movie ticket for that price where I live! But with poker not only do you get the satisfaction of engaging in a skillful endeavor, you actually walk away with something more than a ticket stub! You walk away with keener mathematical and negotiation skills.

I don't believe that poker and the people who play it should be lumped into the category of gambling or be called gamblers. For me, and for other professionals, this is a job, and some of us are better than others. Whether a professional is playing with someone for whom poker is an avocation does not change the question of whether the game itself is one of skill. Yes, for the majority of Americans playing poker is hobby. This is how these people choose to spend their hard-earned dollars and they should have the right to choose how to spend their discretionary income, whether it be on poker or anything else.

There is critical distinction between poker and other forms of "gambling" which is the skill level involved to succeed at the game. I cannot stress this point enough: in poker it is better to be skillful than lucky. I ask anyone in this hearing room to name for me the top five professional roulette players in the world or the number one lottery picker in America. It is just not possible (my apologies to one obvious candidate, Congressman Sensenbrenner). We can however have a real discussion about the top five professional poker players, just like we can have a discussion about the top five professional golfers.

Few can debate the skill elements involved to be successful at poker. From mathematics and probability to psychology and money management, numerous authors and academics have drawn analogies between poker and other endeavors that involve strategic thinking. John Von Neumann regarded as the greatest mind of the first part of the 20th century used analysis of the game of poker in his seminal book on game theory, "Theory of Games and Economic Behavior" as a method of modeling decision-making under incomplete information. When asked why he did not use chess he deferred to the skill elements of poker which encompass all aspects of human intellect, calling chess not a game but merely an exercise in calculation.

Everyone agrees that the betting elements and hand selection involved in poker are skill elements. But I hear people say all the time that poker is only a game of skill for good players and the vast majority of recreational players are playing a game of luck. This is as absurd as asserting that bad golfers are playing a game of luck while only the pro golfers are playing a game of skill. If we all agree that putting and driving and other elements of golf are skill components then whether someone is a good putter or a bad putter doesn't change whether putting is a skill or not. It is the same in poker. If someone is poor at betting or good at betting has no bearing on whether the betting component of the game itself is a skill component.

Go into any bookstore in America and you will likely find a display table covered in books about how to play poker and poker theory. The fact that one can learn poker and get better over time is clear evidence that skill is a dominant factor in the game.

I will concede that chance does play a role in poker. But it is true that chance plays a role in every human activity. Chance plays a role in getting through a traffic light safely. We know that is true because people who exactly follow the rules of the road get in accidents every day across America because of chance. And yet no one is claiming that driving is a game of chance and not a skill! Poker is a game of skill with an element of chance. But to call poker pure chance is just pure ignorance.

To further explain this point, let me try to illustrate it in two ways. If I could program a robot with the rules of poker, when to decide to check, raise, fold, etc. -- but gave it no "skill" so that it made these decisions randomly, that robot would lose nearly 100% of the hands in which it participated.

For those not content with the example of the robot, let me try another approach. One defining characteristic of games of skill is this: a player or team can intentionally lose. If I suggested that you should play slots, roulette, baccarat, or lottery and seek to lose, you could no more make yourself lose than you could make yourself win, as long as you continued playing. However, at golf, tennis, baseball or other games of skill it is entirely possible to lose on purpose. Losing on purpose is playing in defiance of the concept of skill, and thus proves the existence of the skill

element in the game.

Several analogies can be made between playing poker and crafting public policy. But millions of poker-playing Americans were stunned last year when politicians decided that playing Texas Hold 'em over the Internet was so pernicious that the government must deputize financial institutions to prohibit personal financial transactions to certain forms of online gaming.

As we all know, in the closing hours of the last Congress, behind closed doors, Senator Bill Frist managed to slip the UIGEA into the Port Security bill. That law seeks to deputize financial institutions, and have them function as the Internet morality police. Ironically, however, that law did nothing to clarify what actually constitutes an unlawful Internet wager. It exempted certain favored forms of gambling from that bill's enforcement mechanism, but it clarified nothing as legal or illegal.

Instead, Internet gaming is the subject of a hodgepodge of antiquated laws that were intended to govern brick-and-mortar operations. The governing federal statute, The Wire Act of 1961, has been found to only apply to sports betting; beyond that we have a morass of state laws which, for the most part, did not contemplate the Internet. Nevada, North Dakota and Virgin Islands have all taken steps to license non-sports betting, only to be told by the DOJ that even intra-state Internet wagers are illegal.

In the proposed rule issued by the Department of the Treasury and the Board of Governors of the Federal Reserve, the regulators come right out and say that they cannot and will not tell the regulated community what constitutes an unlawful Internet wager. Let me emphasize -- **the posture of the Federal government is, "We are going to create a new federal crime, but we will not tell you what it is."** In the proposed rule, the regulators explain their refusal to resolve this by saying that to do so would require them to examine the laws of the federal government and all 50 states with respect to every gaming modality, and that this would be unduly burdensome. **Yet that is exactly what they are requiring the general counsel of every bank in the country to do.** The committee has received testimony from the association representing providers of pure skill games, such as chess and Tetris, complaining that unless the UIGEA

regulations clarify what they are supposed to cover, they will be unable to hold chess tournaments where people can win money, because, in the absence of clarity, banks will simply block any transaction where people pay a fee to compete and win money.

Poker players believe that the UIGEA regulations should not apply to games where players compete against each other and not against “the house” and where success is predominantly a function of skill. Such games include poker, bridge, mahjong and backgammon, among others. However, because neither UIGEA itself nor the regulations seek to address the issue, we cannot make that case.

Instead, PPA supports certain other legislative initiatives which we believe are more rational. We support H.R. 2046, Rep. Frank’s bill to license, regulate and tax Internet gambling, but which allows states to opt out of the federal licensing system with respect to any and all forms of gaming. We support H.R. 2610, Rep. Wexler’s bill to clarify that poker and other games predominantly determined by skill are outside the ambit of the federal gambling statutes, provided that they incorporate adequate protection against compulsive play, minor play, and money laundering. We also support H.R. 2140, Rep. Berkeley’s bill to commission a National Academy of Sciences study on how to deal with Internet gaming, because we believe any rational examination will verify that licensing and regulation makes more sense than prohibition. However, we believe that the experience of the U.K and other countries can provide the same evidence.

Mr. Chairman, I would like to close with the point I started with: this issue is about personal liberty and personal responsibility -- the freedom to do what you want in the privacy of your own home. I suspect that some on this committee support freedom, except where individuals would use that freedom to make what they believe to be bad choices. “Freedom to make good choices” is an Orwellian term for tyranny-- the governments of China, Cuba and Iran all support the freedom of their citizens to make choices that their governments perceive as good. For those whose religious or moral beliefs hold gaming as abhorrent, I fully support their right to live by those beliefs. I support their right to choose to not gamble. What I do not support, and what this Committee and this Congress should not tolerate, is an effort by those people or anyone else to

prevent me and the millions of people like me from playing a game we find stimulating, challenging and entertaining. However you might feel about gambling on the Internet, I would suggest that gambling with freedom is far more risky.

Again, Mr. Chairman and members of the Committee, I thank you for the opportunity to address you today. I look forward to the testimony of my fellow panelists and the opportunity to engage with you during the question and answer period.

Mr. CONYERS. Thank you so much.

Tom McClusky, Vice President of the Family Research Council—and they study a variety of issues, and for our purposes the one that we are concerned with is gambling policy. He has written, done television, radio. His works have appeared in Forbes magazine, Investors Business Daily, and the Washington Times. We are delighted to have him here as a witness today. Welcome to the Committee.

**TESTIMONY OF THOMAS E. McCLUSKY, VICE PRESIDENT OF
GOVERNMENT AFFAIRS, FAMILY RESEARCH COUNCIL**

Mr. McCLUSKY. Thank you, Chairman and all the distinguished Members of the Committee, for allowing me to testify today.

Part of me was also hoping that Senator Al D'Amato, the well-paid lobbyist for the Poker Players Alliance, would be here and join us today. In one of those odd twists of fate, both the Senator and my Dad used to play poker together when they attended Syracuse University when they were younger. From the stories I have heard, if poker is a game of skill, they could certainly use your teaching there, Ms. Duke.

What the Senator and his colleagues lobby for today, though, is very different from the mostly innocent gambling my Dad and the Senator did way back when. In lobbying for legislation such as Congressman Frank's bill, which seeks to overturn Federal and State laws in relation to Internet gambling, and also the bill sponsored by Representative Wexler which seeks to carve out an exemption for poker, Senator D'Amato and his friends seek to open up a Pandora's box of consequences. Adoption of these bills will lead to an ominous corruption, dissolution of families and disruption of today's delicate negotiations between the United States and other countries.

There are many reasons why Congress originally decided to take a look at Internet gambling. It was only after continued prodding from a unique coalition that Congress finally passed the Unlawful Internet Gambling Enforcement Act, UIGEA, of 2006. This coalition's members represent a wide range of support, not only from organizations like my own and Eagle Forum, but a host of State family groups, religious organizations such as the United Methodists, Southern Baptists, National Council of Churches, every major sports association, many major financial organizations, including the American Bankers Association also supports this legislation. They were joined by the National Association of Attorneys General, the National District Attorneys Association, and the Fraternal Order of Police.

This deep and diverse support on the Federal and State level contributed to a version of the Unlawful Internet Gambling Enforcement Act passing Congress in July of 2006 with a vote of 317 to 93. And it persuaded the Senate to include the bill in the Safe Port Act.

Clearly, this bill was not some fly-by-night piece of legislation, but a well thought-out measure that was years in the making. For the answer to why such a large and diverse group would gather in support of the UIGEA, one need only look at the study that Con-

gress did quite a few years ago in 1999 under the National Gambling Impact Study Commission.

The commission documented the grave toll gambling takes on society. The report estimated the lifetime costs of gambling, including bankruptcy, arrests, imprisonment, legal fees for divorce, et cetera, mounted to about \$10,550 per pathological gambler, and \$5,130 per problem gambler. With those figures, it calculated that the annual cost of pathological gambling caused by the factors cited above were approximately \$5 billion, in addition to \$40 billion in estimated lifetime costs.

This financial cost to gamblers in turn affects their families. The report continued that many families of pathological gamblers suffer from a variety of financial, physical and emotional problems, including divorce, domestic violence, child abuse and neglect, and a range of problems stemming from the severe financial hardship that commonly results from pathological gambling.

Children of compulsive gamblers are more likely to engage in delinquent behaviors such as smoking, drinking and using drugs, and have increased risk of developing problems of pathological gambling themselves. As access to money becomes more limited, gamblers often resort to crime in order to pay debts, appease bookies, maintain appearances, and garner more money to gamble.

Now, the aforementioned concerns address gambling as a whole. When you add the anonymity of the Internet, the troubles caused by gambling increase exponentially. It is the uniqueness of the Internet when it comes to gambling that inspired the aforementioned Dr. Howard Schaffer, the director of Harvard's Medical School's Division on Addiction Studies, to call Internet gambling the "crack-cocaine of the Internet."

Due to the ease with which online gamblers can play from home, online players can gamble 24 hours a day from home with no real sense of the losses they are incurring. Additionally, while many Internet gambling sites require gamblers to certify that they are of legal age, most make little or no attempt to verify the accuracy of the information. The intense use of the Internet by those under the age of 21 has led to concerns that they may be particularly susceptible to Internet gambling.

Now, in September, the British Gambling Prevalence Survey was published by the National Center for Social Research in the United Kingdom. This large objective government study shows the Internet and electronic forms of gambling are far more addictive than traditional social forms of gambling.

Only 1 percent to 2 percent of Britons who play the lottery are problem gamblers. The study found that 1 percent of people who bet on horse races off-line are problem gamblers, and the rate is about 3 percent for bingo and slot machines. Before I get the question, the rate of problem gambling for private betting, as in the case of the Senator and my Dad, was a much lower 2.3 percent, so I think they are okay.

But compare that with the problem gambling rates for people who gamble on computers: 11 percent for fixed-odds betting terminals, similar to video poker or video lottery terminals in the U.S.; 12 percent for systems that take spread-bets and outcomes ranging

from sports races to stock prices; 7.4 percent for other types of on-line betting such as poker.

Now, I see that my time is up, except the aforementioned Annenberg study I think found that the UIGEA is working before it has even had a chance to be implemented. According to PokerSiteScout.com, a website dedicated to web statistics for online gambling sites, a number of online gambling operators has stopped accepting bets from players identified to be in the United States.

Now, as I can picture my Dad saying to former Senator D'Amato and the questionable alliance behind him, when you have the law, the States, financial institutions, religious and family organizations and an array of law enforcement agencies against you, it is about time to fold your cards and go home.

Thank you.

[The prepared statement of Mr. McClusky follows:]

PREPARED STATEMENT OF THOMAS E. MCCLUSKY

Thank you, Mr. Chairman, and all the distinguished Members of the Committee for allowing me to testify today. Part of me was also hoping that former Senator Al D'Amato, the well-paid lobbyist for the Pokers Players Alliance would join us here today. In one of those odd twists of fate the Senator used to play poker with my Dad many years ago when they were at Syracuse University together.

However, what the Senator and his colleagues lobby for today is very different from the mostly innocent gambling they did back in their youth. In lobbying for legislation such as Congressman Frank's bill, H.R. 2046, which seeks to overturn federal and state laws in relation to Internet gambling, and H.R. 2610, sponsored by Representative Robert Wexler (D-FL), which seeks to carve out an exemption for on-line poker, they seek to open up a Pandora's Box of consequences. Adoption of these bills will lead to anonymous corruption, the dissolution of families, and the disruption of today's delicate negotiations between the United States and other countries, notably the United Kingdom and Antigua.

There are many reasons why Congress decided to take a look at Internet gambling, and it was only after continued prodding from a unique coalition that Congress finally passed the Unlawful Internet Gambling Enforcement Act of 2006. This coalition's members represented a wide range of support not only from organizations like Family Research Council and Eagle Forum and a host of state family groups, but also from religious organizations such as the United Methodists, Southern Baptists and the National Council of Churches. Every major sports association and many major financial organizations including the American Bankers Association also supported the legislation. They were joined by the National Association of Attorneys General, the National District Attorneys Association, and the Fraternal Order of Police. This deep and diverse support on the federal and state level contributed to a version of the Unlawful Internet Gambling Enforcement Act passing Congress in July of 2006 with a vote of 317-93, and it persuaded the Senate to include the bill in the SAFE Port Act.

Clearly this bill was not some fly-by-night piece of legislation but a well-thought-out measure that was years in the making. For the answer to why such a large and diverse group would gather in support of the UIGEA, one need only look at the National Gambling Impact Study Commission, which was created by Congress in 1996 and issued its final report in 1999. The Commission documented the grave toll gambling takes on society. The report estimated that lifetime costs of gambling (including bankruptcy, arrests, imprisonment, legal fees for divorce, etc.) amounted to \$10,550 per pathological gambler, and \$5,130 per problem gambler. With those figures, it calculated that the aggregate annual costs of pathological gambling caused by the factors cited above were approximately \$5 billion, in addition to \$40 billion in estimated lifetime costs.

This financial cost to gamblers in turn affects their families. The report continues that "many families of pathological gamblers suffer from a variety of financial, physical, and emotional problems, including divorce, domestic violence, child abuse and neglect, and a range of problems stemming from the severe financial hardship that commonly results from pathological gambling. Children of compulsive gamblers are more likely to engage in delinquent behaviors such as smoking, drinking, and using drugs, and have an increased risk of developing problem or pathological gambling

themselves. As access to money becomes more limited, gamblers often resort to crime in order to pay debts, appease bookies, maintain appearances, and garner more money to gamble.”

The aforementioned concerns address gambling as a whole. When you add the anonymity of the Internet, the troubles caused by gambling increase exponentially. The theft of credit card numbers from customers is a very real concern and it is much easier for gambling web sites to manipulate games than it is in the physical world of highly regulated casinos. Additionally, gambling on the Internet provides remote access, encrypted data and, most importantly, anonymity. Because of this, a money launderer need only deposit funds into an offshore account, use that money to gamble, lose a small amount of that money, and then cash out the remaining funds.

It is the uniqueness of the Internet when it comes to gambling that inspired Dr. Howard Shaffer, the director of Harvard Medical School’s Division on Addiction Studies, to call Internet gambling the “crack cocaine of the Internet” due to the ease with which online gamblers can play from home. Online players can gamble 24 hours a day from home with no real sense of the losses they are incurring. Additionally, while many Internet gambling sites require gamblers to certify that they are of legal age, most make little or no attempt to verify the accuracy of the information. The intense use of the Internet by those under the age of 21 has led to concerns that they may be particularly susceptible to Internet gambling.

Problem gamblers between the ages of 18 and 25 lose an average of \$30,000 each year and rack up \$20,000 to \$25,000 in credit card debt, according to the California Council on Problem Gambling. In a health advisory issued by the American Psychiatric Association in 2001, ten percent to 15 percent of young people reported having experienced one or more significant problems related to gambling.

In September, the British Gambling Prevalence Survey 2007 was published by the National Centre for Social Research. This large, objective government study shows that Internet and electronic forms of gambling are far more addictive than traditional and social forms of gambling. Only 1–2% of Britons who play the lottery are problem gamblers. The study found that 1.7% of people who bet on horse races offline are problem gamblers, and the rate is about 3% for bingo and slot machines. But compare that with problem gambling rates for people who gamble on computers: 11% for fixed-odds betting terminals (similar to video poker or video lottery terminals in the U.S.), 12% for systems that take spread bets on outcomes ranging from sports to political races to stock prices, 6% for online betting with bookmakers, and 7.4% for other types of online betting, such as online poker. The data is unequivocal: gambling online is several times more addictive, and regulation of online gambling in Britain doesn’t change this fact.

And before I get the question, the rate of problem gambling for “private betting,” as in the case of my Dad and Senator D’Amato many years ago, is a much lower 2.3%.

In June of this year an aggrieved father, Pastor Greg Hogan, Sr., gave powerful testimony to the House Financial Services Committee on how his son, also named Greg—a college student with a bright future ahead of him—became addicted to online gambling. Mr. Hogan told the heartbreaking story of how his son became obsessed with playing poker online and, due to the ease with which it was offered to him (as it is offered to college students across the U.S.), Pastor Hogan’s son soon found himself saddled with such deep losses that he turned to bank robbery to pay his debts. Now the main debt Greg Hogan, Jr. is paying is to society in the form of a 20-year sentence in federal prison. What Greg Hogan, Jr. did was wrong and he is paying for it. However, his family and other families continue to suffer as those they love become obsessed with Internet gambling.

By passing the Unlawful Internet Gambling Enforcement Act of 2006 Congress was sending a strong message that it was willing both to protect states’ prerogatives and to protect families. Even before the recent release of the Department of Treasury’s regulations in connection with the UIGEA, Congress’s efforts to combat unlawful Internet gambling showed immediate fruit.

A recent National Annenberg Survey Center study found that the number of college students who gambled in 2006 fell by 70 percent the next year, following the passage of the UIGEA. The new law restricts banks from transferring funds to Internet gambling sites, all of which operate outside the U.S., so many sites closed as a result.

According to Pokersitescout.com, a web site dedicated to web statistics for online gambling sites, a number of the online gambling operators have stopped accepting bets from players identified to be in the United States and the overall use of these sites has dropped drastically. These losses for online gambling sites are victories for American families; it would be a shame if this Congress decided to reverse the rare

strong bipartisanship and rapid progress that have been shown on this important issue.

As I can picture my Dad saying to former Senator D'Amato and the questionable alliance behind him, when you have the law, the states, financial institutions, religious and family organizations, and an array of law enforcement agencies against you—it is time to fold your cards and go home.

Mr. CONYERS. Thank you very much, Mr. McClusky.

Mr. Michael Colopy is the Vice President of Aristotle, Incorporated, a major developer of computer software, and has recently developed one brand called INTEGRITY, which provides comprehensive age and identity verification services to its customers. This verification software has been featured very widely and I think he would want to explain it a little bit further.

Welcome to our hearings today, sir.

TESTIMONY OF MICHAEL COLOPY, VICE PRESIDENT FOR COMMUNICATIONS, ARISTOTLE, INC.

Mr. COLOPY. Thank you, Mr. Chairman.

As somebody who worked here many years ago on the Democratic side of the aisle, it has been something I learned from previous Chairmen that unless strong coffee has been served, it is best not to read your statement if there have been witnesses ahead of you. So taking that advice, I am going to paraphrase what I have to say, and also get to some issues that have been touched on earlier so that the Q&A might be more practical in its focus.

Also, I should add that despite the fact that Aristotle is one of the global leaders in age and identity verification, I am not, technologically speaking, the sharpest card in the deck, with apologies to Ms. Duke. But there are policy issues and there are practical modalities that we need to discuss that directly respond to issues that have been raised—two in particular.

One is, of course, screening out the underaged. I was happy to hear that Congressman Goodlatte did not say again what was said here last year, which we never had the chance—we were not called, as we were today, so we weren't here to present evidence to the contrary. But for a few years, responsible major industries that wished to adhere to best practices and reflecting the fact that the courts have always held the State has a compelling interest in protecting children, they sought to use technology not just to market, but to protect.

When it comes to those who are underage, of course, there are restricted products and services—tobacco, alcohol and so on. These industries, and today on a massive scale, deploy age and ID verification to screen out the underaged. In fact, screening online is far more effective than checking a driver's license at the local 7-11.

There simply is no argument to be made anymore and there hasn't been for a while, that effective and available age identification is deployable and affordably so. That is being done by the largest beer brewers in the United States today. It is being done by 358 major financial institutions. It is being done by distillers. It is being done even by State lotteries.

The second question I wish to address of the two principal ones is the one of protecting people from themselves. Aside from the philosophical issue of it—and I must say this is the second hearing

in which we have been asked to testify where I have heard John Stuart Mill mentioned. Perhaps he should be made an honorary witness at the table hereafter. But the argument that addiction per se is a disqualification for the implementation of a given policy is one that can and must be addressed in terms of its practical solutions.

One thing that this company did when it went first way out on a limb, and now became the leader in this field, it sought to look at the social downside and benefit to the use of its technology. It created something called the "self-exclusion list." SEL is a global system that allows an individual, acknowledging addiction, to put themselves within the system so that any casino, online or bricks and mortar, when they present their identification would essentially as a proxy for that individual, exclude them as voluntary self-therapy.

It is only one of many pieces if we are talking about therapy, but nonetheless, to help an addicted individual avoid relapse is one piece of that therapy. It is something that social service organizations the world over recognize the value of. It also directly addresses the question of whether or not there are tools that can be built into the system to address addiction and are also currently available and deployable. And yes, indeed, they are.

There are other points to be made. For example, the question of verification, and I know from questions I have from Members that there has been some confusion, particularly because in dealing with alcohol over the years, the Federal Trade Commission has used the term "verification" in a rather sloppy way, allowing for example that sites that simply have an age screen that says "you must be 18, tell us you are 18 and in you go," can and should not be characterized as verification. I mean, every run-of-the-mill legal or illegal operation can do this and does it. In fact, the most disreputable ones do it with more panache than legal ones.

So I would point out, and I would ask the Committee if its definition corresponds to the Latin roots of this word, that is "to establish as true." That is the term as we use it, as verification. Ronald Reagan was mentioned earlier. In the entire negotiations over strategic weapons limitation, verification was used as the standard of immutable proof beyond arbitrary self-selection or self-attestation. So in the case of verification as we use the term and as we deploy it, it is against public records of data. It is not somebody simply alleging that they are of age.

And finally, there is the question of credit card usage. Credit cards are common among teenagers, my own included. They cannot and should not be used as proxies for age, as the credit card issuers themselves say. That is something that also should be addressed in discussing these issues.

Thank you very much.

[The prepared statement of Mr. Colopy follows:]

PREPARED STATEMENT OF MICHAEL COLOPY

Mr. Chairman and Members of the Committee, good morning.

I am here at the Chairman's request as the representative of Aristotle Inc., a leading provider of verification services for child protection online. Age and ID verification online first emerged several years ago as a solution of choice for many industries concerned about their social responsibilities to the broader society, espe-

cially where their marketing and sales efforts might reach underage teens or expose children to risk. Even three years is a generation in the lifecycle of technology. The Internet has brought an acceleration of technological remedies that are far more effective today than they were at the start of the last Congress: state-of-the-art online verification illustrates this pattern.

The Sixty Minutes report you just viewed is a relevant illustration of how in the instance of online gaming robust technology can be used by responsible private enterprise to perform a necessary social good. But the robust verification capability you witnessed is unfamiliar to those who do not follow these technological developments closely. As recently as last fall, some Members of this body professed to be unaware of the online age verification and ID methods the CBS report appropriately demonstrated, giving this as their reason to support the selective online gaming ban. Yet, the tech savvy son of the producer of Sixty Minutes could not enter the gaming site that uses an effective verification service but easily penetrated those that do not deploy it. That report first aired in November, 2005: the robust system that kept the youngster out of the gambling site is even more effective today and in vastly more widespread use across the United States and in other parts of the world.

I am here as a stand-in for John Phillips, the CEO of Aristotle Inc. whose age and ID verification system, INTEGRITY, is the backend of the effective system in the unscripted test you just saw. Commenting on what Aristotle does for its many clients is not our custom but we were persuaded to appear because of erroneous assumptions about age verification that should not be left uncorrected, particularly where they pertain to child protection.

America is a society guided by humane principles: we are also an economy built on free enterprise. In the context of today's hearing, therefore, there are two considerations that should guide this exploration: First, what is necessary to provide reasonable protection to society's most vulnerable members, reduce fraud and mitigate risk, and, second, how is the market choosing to do this?

Over the last ten years, law enforcement and consumer protection agencies as well as industry self-regulatory bodies have recognized the need for rapid online identity verification for Patriot Act and anti-money laundering compliance, fraud prevention and for risk mitigation involving age-restricted products such as tobacco, alcohol, pharmaceuticals, video games and mature content from many sources.

Alongside the steep rise in public concern, online age and ID verification has matured as a needed solution such that any merchant may do online what is routinely done at stores every day across America. In fact, as ever more efficient technologies and databases have been developed, online transactions have become in many instances faster and less risky than the visual driver's license scans that suffice for alcohol or cigarette purchases in America's neighborhood convenience stores, restaurants and bars. And although it is certainly true that no manmade system is foolproof—whether it be a seatbelt, an airbag or an airplane, the verification methods now deployed justify a relatively high degree of confidence. Which is why they have earned broad adoption across American commerce.

Government agencies that monitor commerce have been notably slower than the market in recognizing what has been happening but that too is gradually changing. The Federal Trade Commission and other agencies have urged that reliable state-of-the-art methodologies available on the market be deployed to protect children from accessing promotions intended only for adults. In its 2003 report to Congress on the marketing of beverage alcohol products, the FTC pointed to the emergence of online methods, and Aristotle's service in particular, as addressing this public need. (*See FTC Report to Congress: Alcohol Marketing and Advertising September 2003*).

Aristotle's INTEGRITY verification technology is one logical response to the acute need of marketers for reliable, robust and commercially reasonable protective screening that also addresses important privacy and security concerns. Depending primarily on public records data rather than on personal financial information, INTEGRITY comprises several levels of authentication in a methodology that matches process to risk. The INTEGRITY system is now a major component of the private sector's accommodation of mounting public pressure for a technological solution that is both socially responsible and commerce friendly.

According to Forbes Magazine, Aristotle's INTEGRITY verification service is the market leader in online identity and age verification. INTEGRITY is utilized today by global Fortune 1000 enterprises that are required either by law or best-practices professional codes of conduct to identify individuals requesting permission to enter a facility, a website, open an account or conduct certain transactions online.

Institutions relying on INTEGRITY include more than 350 of the nation's largest financial services companies, government agencies and airport security authorities,

wineries, distillers, makers of premium cigars, video game publishers and the major motion picture studios. In general, the firms with the greatest market share are the most assiduous users of INTEGRITY.

It is utilized to comply with the multi-state Tobacco Master Settlement Agreement provisions that prohibit marketing to minors. The service exceeds the strict standards of such laws for online age-verification as California's Business and Professions Code § 22963, and Virginia Code § 18.2-246.8, governing online tobacco sales. Aristotle's INTEGRITY service offers indemnification in the event of failure. Since adoption, not once has that happened. Blocking underage teens from purchasing tobacco online is believed by most citizens to be an important social value. (The Campaign for Tobacco-Free Kids (<http://tobaccofreekids.org/Script/DisplayPressRelease.php3?Display=425>) presents the urgency of this issue on its website.)

Hollywood has also seen the wisdom of the new approach to marketing. The major motion picture studios use INTEGRITY to comply with the Motion Picture Association of America (MPAA) guidelines for restricting minors' online access to studio promotions with "R" rated content. In fact the overwhelming majority of visitors to studio sites with restricted ads are age verified through Integrity.

Vendors in the beverage alcohol business use INTEGRITY as well. In the new era of direct wine shipments, for example, online age verification has become an essential component for compliance and responsible marketing across the United States. Without a verification service such as INTEGRITY, Members of Congress and the general public would not be able legally to purchase fine cigars, wines, lottery tickets or R-rated movies by mail, by telephone or online.

Another social mandate that relates to the question, online gaming, before the committee today, that INTEGRITY is designed to meet is in the area of problem gambling. In addition to the risk mitigation and child protection benefits of age and identity verification, this service benefits those individuals who acknowledge that they are problem gamblers and wish to avoid relapse. There are several components to effective therapy for this affliction but allowing an individual to establish a blocking mechanism is one part of such a program. A central self-exclusion list program (SEL) has been under development over the last several months and is now deployed. Through the SEL individuals will be able to put their own names on a confidential list of those who do not wish to be solicited or allowed to open an account with a casino. As with all data in the INTEGRITY system, the list is strictly confidential, and the names would not be disclosed to anyone. Individuals could remove their names from the list after a set minimum period.

In the United Kingdom, INTEGRITY is widely used by licensed casino operators to comply with the strict UK requirements for age verification online.

The question sometimes arises: in the web world, how can a governmental jurisdiction mandate the exclusion of persons entering online from outside its authority? The method is known as IP geo-location. It's true that some IP addresses can only be identified at a country level. And there are certain types of proxies and satellite IPs that prevent us from geo-locating and that the geolocation technology can't be applied to long-distance modem dialup calls (e.g., a user from California calls a dialup number in New York).

The good news is that we can identify these **types** of IP addresses. And these IP addresses are assigned low confidence scores.

Organizations like the New York Lottery and the BC Lottery only use IP addresses that are scored at near 100% confidence, meaning that we are nearly 100% certain that any given IP address correctly correlates with a location. Addresses not scoring very high are excluded.

Overall these exclusions represent only a very small percent.

The solution allows us to be 100% compliant. Because we are only delivering IP addresses that are scored virtually at the 100% confidence level, we are able to adhering to the lotteries' strict compliance requirements.

As a practical matter, everyone in this room at some time orders airline tickets or executes some similar transaction where the vendor needs to be fairly confident that the purchaser is who he says he is. This kind of real time vetting online is now routine.

In their determination to "do the right thing" and comply with the law while marketing responsibly under best practices standards, a large and growing number of enterprises across the broad spectrum of American commerce have adopted online age and ID verification. The market leaders have spoken and there is no ambiguity remaining. Simply put, they have opted for responsible child protection in the form of state-of-the-art online age and identity verification, making effective age and ID verification the norm. The substantial and growing danger, especially to the young, that unrestricted access over the Internet represents has stimulated technological solutions by the private sector such as INTEGRITY.

In its simplest terms, the case for deploying this child protection measure has never been more apparent or compelling. Age and ID verification is efficient, effective, reliable and available nearly everywhere.

Thank you. I look forward to responding to your questions.

Mr. CONYERS. This has been a very engaging morning for us. I would like to ask, starting with Ms. Hanaway, to indicate anything that she has heard here from her co-panelists that she would want to give us some comment about or caution the Committee or take mild issue with, or anything else she may be thinking that is reportable in the record.

Ms. HANAWAY. Mr. Chairman, that is a very broad question. Thank you for that opportunity to comment on some of what the other panelists have said.

I think I might be better to defer to more specific questions. I will say this about the last witness' testimony. Boy, it would be helpful to law enforcement if there were real online verification ability of age, but almost in the reverse of the context that he just described.

If we could verify that those going on sites that were available to underage kids really were under the age of 18 and not child predators; if we could really identify who people were because the context from a prosecutor's perspective in which we most often see people making misrepresentations about their age is in the context of predators preying on children and saying that they are under 18. So if we could find a tool that really was verifiable, it would be helpful. It really would.

Mr. CONYERS. Mr. Colopy?

Mr. COLOPY. Well, I am delighted to tell the Justice Department that the very tool I described does exactly that. In fact, in the INTEGRITY system, we also have access to complete registered sex offender lists. So not only can you establish that someone stupid enough to come in under their own name and is a registered sex offender is now in your site, we can also verify that every person coming in is of a certain age, and if there is an anomaly, they don't get on. So the solution that you are looking for, ma'am, exists.

Mr. CONYERS. Ms. Hanaway?

Ms. HANAWAY. If I understand correctly, and I really want to understand correctly, Mr. Chairman, I think that his system works only if the person logs on to whatever computer service they are using by putting on their own identity. The situation we most often find is that people pose as someone else. I don't know that the system that has just been described has an ability to detect whether you are using someone else's identity as you are logging on.

Certainly, it is easy to find sex offenders if they log on using their own identity, but most often they pretend to be someone else. From what I have heard, I don't see how the system screens for that, screens for either a minor who wants to gamble, taking the identity of a parent or an aunt or an uncle, or a sexual predator taking the identity of someone else and going online, someone who really exists and really is of age-appropriate and economic-appropriate status.

Mr. COLOPY. Well, first of all, it is important to say that as with seatbelts, airbags and anything else, no system is perfect. But the system that we are deploying has many different points of

verification. I am not sure if you have it, but 60 Minutes did a test of this to demonstrate definitively.

It did actually what they thought was a sting on a site where a CBS producer's son attempts to get on the Internet using his father's credit card and posing as his father, and was repeatedly rebuffed. He never succeeded, which was startling. However, when they went to systems that did not have robust age verification, including some outside the country, he got in rather easily.

So without telegraphing to every teenager what all those points of data are, I wish to emphasize emphatically that the issue that has been raised is addressed by the technology we are deploying today.

Mr. CONYERS. Ms. Duke, what have you heard here that would make you want to make a comment at this point?

Ms. DUKE. That is a dangerous question to ask me. I want to just respond very quickly to Ms. Hanaway's concern that only if you log on as yourself can you identify someone. There is technology out there right now which is called SNARE. It is from a company called Iovation, which is out of Portland, Oregon. It is used by such companies as, for example, Dell Financial Services Online.

It is a new technology and it is patented. It has to do with device sharing, as opposed to worrying about who a person is, once a person is logged onto a computer and been identified as a bad guy, then any computer that that person is related to will also be shut down if you choose to. You can set the SNARE or the trap for as wide as you want, for as many associations as you want.

So for example, if I log on and they find out I am a minor or they were to find out that I was, say, a compulsive gambler or someone who is a predator, and I logged onto a computer, if I had logged onto another person's computer, their computer would get shut down and then whoever that computer, that user had shared a computer with would also shut down. So it is like if you tell two friends, if we remember that commercial, it is like that. And again, you can set the trap for as wide as you want.

What that does is it makes it so that someone cannot create new accounts. If they create a new account, it is their computer that is tagged as bad, and not their account that is tagged as bad, and actually not their personal identity that is tagged as bad. In fact, the software is completely blind to the person's identity. They only care about the device.

Now, the interesting thing about this is that these devices are shared by any company that chooses to use these services. So once Dell Financial Services, for example, finds out that there is a bad guy on their network, then if MySpace chose to use this, that person would be identified as bad automatically for their network. They wouldn't have to do a bad thing on MySpace for MySpace to know about them.

So there certainly is a lot of really good technology out there that is completely blind to the user and only interested in the device, which is a much more powerful way to stop these people from getting online.

As a second point, as far as the prosecutions that have taken place in the Justice Department, my understanding is that they only apply to companies that are engaged in sports betting, that ac-

cept sports betting wagers, as they should, because the Wire Act of 1961 clearly states that sports betting is illegal. However, there aren't any prosecutions that pertain to poker because the Federal decisions that we have on that up to the Fifth Circuit Court state very clearly that poker is not covered by the Wire Act.

So I am not sure how that is germane necessarily to the UIGEA which clearly states that if an activity is legal in the State, then it should remain legal in the State because it doesn't supersede the Wire Act. And if it is illegal in a State, then it should remain illegal in a State, that that is really a State-by-State issue that now has some Federal governing to it. So yes, the people from BetonSports got prosecuted. They were accepting sports wagers. NetTeller was involved in sports wagering and so have all the other prosecutions that have been involved.

As far as Mr. Goodlatte's testimony to the individuals, and Mr. McClusky's, that have bankruptcies in their family, I just want to say quickly that if we start legislating based on individual cases of people having bankruptcy, we are going to be in pretty big trouble because we are going to have to legislate basically every activity.

The issue for me is that people make bad decisions all the time that create bankruptcy and problems in their family. For example, accepting a sub-prime zero percent down mortgage has created a lot of bankruptcies recently. Online shopping or shopping in real life has created a lot of bankruptcies.

If we choose to be on every activity that creates financial hardship in a family, we are going to be banning basically every activity. If we choose to ban anything that hurts a family, we are going to be banning McDonald's, for example, because many fathers die prematurely from eating fatty foods and leave their children with no means to support themselves, and you know, a lot of ruining of lives occur because people are eating too many McDonald's' hamburgers. I would hope that we aren't going to ban that either.

Mr. CONYERS. Thank you.

Before we go to vote, we are going to recognize Mr. Smith, but I have to ask Professor Weiler what he has made of the discussion with his fellow panelists.

Mr. WEILER. Mr. Chairman, thank you. I was struck not by what I heard, but what I did not hear. In particular, I would be interested in the position of the Justice Department if, for example, say China hypothetically, were to prosecute an American citizen and put them in prison in violation of an international legal obligation owed to the United States.

Simply they would say to the United States that under our internal Chinese law, this individual has no defense, despite the fact that we recognize that we are violating the international obligation to you, and then China moved to withdraw the commitment they had given to the United States. What would be the position of the Justice Department in such a situation, with a little rider, that China would add, "and we have learned this trick from you"?

Mr. CONYERS. What do you think, U.S. Attorney?

Ms. HANAWAY. Well, I think it would be unwise, Mr. Chairman, for me to try and answer a hypothetical situation that does not exist. I will say that we are currently in the district for which I am U.S. attorney prosecuting BetonSports; that there have been

motions made suggesting that our prosecution violates the World Trade Organization treaties. Obviously, this is currently being litigated, so I can only talk about the positions we have taken on the public record, and those are essentially two.

The first is that this Congress in enacting the statutes necessary to carry out those treaties said in the law that nothing in those treaties would overturn existing laws of the United States. The Wire Act was already the law when those treaties were executed. The second position that we have taken which really doesn't go to this country-to-country discussion is that the defendants as private citizens don't have a right to challenge under the treaty.

Mr. CONYERS. Are you mildly satisfied, Professor Weiler?

Mr. WEILER. Of course, Ms. Hanaway has answered honorably, and that indeed is the position taken. I think it is a very unfortunate position for the rule of law and for the reputation of the United States in the world order. It is creating a highly dangerous precedent for our own citizens trading in other countries.

Mr. CONYERS. Ms. Hanaway, why did you not mention horse racing in your list of prosecutions in Internet gambling?

Ms. HANAWAY. Well, I was highlighting, Mr. Chairman, some of the more notable prosecutions that are currently going on. There was no particular reason not to mention horse racing.

Mr. CONYERS. Well, it has been noted that they are frequently excluded from prosecution, generally, not in your area. You didn't know that.

Ms. HANAWAY. I had not heard you note that. I have heard you note it now. I am not sure if there is a question in your notation.

Mr. CONYERS. Oh, there is. [Laughter.]

Ms. HANAWAY. I am sure of it.

Mr. CONYERS. Mr. Smith?

Mr. SMITH. Mr. Chairman, will we return after the vote?

Mr. CONYERS. You don't want lunch, so the answer is yes, absolutely, after the votes.

Mr. SMITH. Mr. Chairman, I will try to be brief.

Ms. ABEND, when do you expect the regulations to be in effect for the enforcement act?

Ms. ABEND. Thank you, Congressman, for asking about that. We obviously are in the opportunity right now of an open comment period which ends next month on December 12. Our intent, just as in the timeframe of when we promulgated the proposed rule, is to work very closely with the Federal Reserve Board and the Department of Justice in a timely and thorough manner.

Mr. SMITH. Right. I understand all that. When do you expect them to be effective?

Ms. ABEND. Well, Congressman—

Mr. SMITH. Give me an estimate roughly.

Ms. ABEND. Congressman, until the comment period is closed, it would be very difficult for me to say. We need to go through all of those comments. We expect an awful lot.

Mr. SMITH. Okay. I won't pursue it, but it doesn't seem to me it was that difficult of a question.

Ms. Hanaway and Ms. Abend, what gaps are there in the current law that need to be closed in order to properly enforce the prohibi-

tion on Internet gambling, particularly with regard to payments or anything else? Ms. Hanaway?

Ms. HANAWAY. Well, certainly it is the position of the Department that Internet gambling in all forms is illegal under the laws today.

Mr. SMITH. Are there any gaps in current law?

Ms. HANAWAY. I think it would be helpful to have some of the further clarifications that were contained in legislation Congressman Goodlatte proposed last year. Perhaps some further specification of the specific forms of gambling that are covered, although we do believe and take the position that all forms of gambling, including poker, are covered by existing law.

Mr. SMITH. Okay.

Ms. Abend, any gaps in the current law that need to be closed?

Ms. ABEND. Thank you, Congressman, for your question. Treasury Department is not seeking additional authorities at this time.

Mr. SMITH. Okay. Thank you.

Ms. Duke, I have a couple of questions for you. First of all, congratulations on your success. I have to say, you certainly got your money's worth from that Ph.D.

Two questions. One, do you see any distinction between poker and other forms of gaming, or do you think they are all the same?

Ms. DUKE. No. From a civil liberties standpoint, I would call them all the same.

Mr. SMITH. Okay.

Ms. DUKE. However, there is a very huge distinction between poker and other forms of gambling. Other forms of gambling are house-banked and are designed so that the house has an edge. So that when someone chooses to play them, they know that they are mathematically guaranteed to lose in the long run, but they are choosing to try to get lucky in the short run.

Poker is a game where you can play with an edge because it is a game of skill. So it is a game that you can get better at that actually has quite a bit of social utility in terms of, for example, enhancing mathematical skills or negotiation skills. In fact, John Von Neumann—

Mr. SMITH. Let me stop you there. I will take your word for that. I want to ask one more question before we have to leave.

Ms. DUKE. Okay.

Mr. SMITH. In the last James Bond movie called *Casino Royale*—

Ms. DUKE. Yes.

Mr. SMITH [continuing]. James Bond draws an inside straight flush. What are the odds of that occurring? [Laughter.]

Ms. DUKE. An inside straight flush will happen with one card to come 2 percent of the time, but that doesn't mean that it is a game of luck. It means that 98 percent of the time, he wouldn't have had that, and it frankly shouldn't have been involved in that hand, and a good player knows that because we play with an edge and we constantly get ourselves into mathematical—

Mr. SMITH. I am not questioning your skill at all. So it is 2 percent on an inside straight flush.

Ms. DUKE. Right.

Mr. SMITH. What about a royal flush?

Ms. DUKE. Well, a royal flush will happen about one in every 6,000 or so hands, but you can use any cards from your hand whatsoever in Texas Hold'em. It is different for different games.

Mr. SMITH. Mr. Chairman, I think we are getting free tutoring today.

Ms. DUKE. But the fact that I know those statistics shows that it is a game of skill, even in the short run, even in one hand or one turn of the card.

Mr. SMITH. Okay. Thank you, Ms. Duke.

I yield back the balance of my time.

Mr. CONYERS. The Committee will stand in recess for a while. We hope that we can have our guests go back to the room there, because your discussions among each other are very important. They help us in flushing out some of these very complex questions. So let us stand recess until the votes are taken.

[Recess.]

Mr. CONYERS. Excuse the voting necessities of the Committee.

The Chair recognizes the gentleman from Florida, Bob Wexler.

Mr. WEXLER. Thank you very much, Mr. Chairman. I first want to thank the Chairman for holding what I think is an extremely compelling and illuminating hearing. I particularly found Ms. Duke's testimony with respect to the personal freedom aspect of what we are talking about today to be especially important; the professor's testimony regarding the trade and economic implications of the unlawful Internet Enforcement Gaming Act to be extremely important; and I found equally compelling the testimony from the Department of Justice, from Ms. Hanaway, equally compelling because of its sweeping nature. Mr. McClusky's citation of the moral aspects and the grave toll that gambling takes I think is also worthy of some examination.

If I could, Mr. Chairman, just to take a step back, just to give people a sense of the environment in which we operate. More Americans watch professional poker on television than watch NBA basketball. So more Americans are watching Ms. Duke and her colleagues play poker than are watching Shaquille O'Neal and Dwayne Wade. That is how popular poker is in America. More Americans are watching poker than watch baseball in the United States.

The fact of the matter is, poker has been played for decades in the White House. It has been played in the halls of Congress. And don't get me wrong, I am all for it, and I suspect it has been played at the Supreme Court, and more importantly it is played in millions of kitchens across America and millions of dining rooms across America.

The fact is, poker is America's pastime game, and it is a game of skill. That is the venue in which we operate, except that the last thing that the last Congress did with the now-minority when it was a majority, was to say that playing poker on the venue of the 21st century, the Internet, would be illegal, and that it needs to stop.

That is why we are here, Mr. Chairman. And let us talk about some of the supposed declarations. The very distinguished Ranking Member talked about the fact that we have a prohibition of Internet gambling. We do not have a prohibition of Internet gambling. We do not prohibit betting on horses on the Internet. We do not

prohibit betting on lotteries on the Internet. We don't prohibit betting on fantasy sports on the Internet.

To Mr. McClusky, I would respectfully suggest, and I respect your morals, I certainly do. You have every right to believe as you do. And I respect that. But I find it hard intellectually to understand why it is moral to bet on a horse running around a track, but if it is a dog, if it is a greyhound running around the track somehow it is immoral, according to this Congress. I don't get the distinction.

Mr. McCLUSKY. If you would like to introduce legislation to ban horse racing, FRC would be glad to look at that.

Mr. WEXLER. Well, what I would like to do is actually have legislation that treats all gambling the same. Either we prohibit it all because we are morally so offended, or we let it all be up to the personal freedom of Americans to decide. But to cherry-pick as a Congress is what I find particularly intellectually dishonest.

I guess my question would be respectfully to Ms. Hanaway. I found your response to the Chairman's question interesting—the question regarding horse racing. It would be interesting if you weren't in the Department of Justice, if you were at the Treasury, it might be interesting; if you were just a private citizen, it might be interesting.

But we do not, at least as I understand it, we don't prohibit the betting of horse wagering on the Internet, yet you testify that it is the Department of Justice's position that all forms of Internet gambling are prohibited. But you tell the Chairman that horse tracks are not subject to any of the activities of the Department of Justice.

Your testimony is that the statute applies to both sporting events and other forms of gambling. But yet, that seems to ignore what was the Fifth Circuit decision, if I understand it correctly, understanding that Missouri is only an authority, but not a controlling authority in your jurisdiction. But if I understand the state of the law is that it is only sport betting that is specifically prohibited by the current state of the law, and yet you tell us the Department of Justice takes the position that all forms of Internet gambling are prohibited.

Why aren't we, if that is the case, prosecuting every lottery director in America? Why aren't we prosecuting everybody who shows up at an off-track horse-betting establishment in America? Why aren't we prosecuting every fantasy sports outlet in America? Don't get me wrong. I don't want that to happen. But you are the Department of Justice. This is the state of the law. Please tell me, where do I have it wrong?

Ms. HANAWAY. Thank you for your question, Congressman. Let us start with I think something either that you mis-heard or I mis-stated. And that is that whether we as a Department believe that placing bets over the Internet on horse racing is illegal. We do believe and take the position that it is illegal. We have prosecuted cases. Horse racing betting is a portion of the current prosecution we are doing against BetonSports. It was also the primary means of betting and wagering in a prosecution done in the Southern District of New York. The name of the case was the *United States v. Uvari*.

With respect to the Fifth Circuit case, that is the one case that has held that 18 U.S.C. Section 1084 does not apply to poker wagers. That was litigation between private parties. The United States was not a party to that case. We have consistently taken the position that poker is covered by that statute, but also importantly by two other statutes that were not litigated in that case: 18 U.S.C. 1952 and 1955. At least one magistrate judge in the Eastern District of Missouri has said we are correct in that interpretation of the Wire Act, including section 1084.

Mr. WEXLER. If I may, Mr. Chairman, has the Department of Justice shut down a single e-lottery system in the United States? And if you haven't, why not?

Ms. HANAWAY. Congressman, I don't know that I can answer your question. I don't know if in fact the Department has done that anywhere. I would be happy to get more information to follow up with submitting an answer in writing.

Mr. WEXLER. The beauty of the Department of Justice's position, as you enunciate it, which is all forms of Internet gambling are prohibited, means there is no gray area. Shut it all down. So when we see selective enforcement, that is what suggests a very untoward result in some of our minds. That is what appears to be the state of the law. This idea that we prohibit Internet gambling is a fallacy. People are legally doing it millions of times every day in America.

If I could close, Mr. Chairman. Mr. Smith earlier and Mr. Goodlatte as well make I think some very valid points on the issue of underage gambling. It is a serious problem. I think we all take it extremely seriously. Mr. Colopy I think gave excellent testimony in terms of how it can be avoided.

The irony is, the irony with respect to the state of the law as we see it, is that there is more likely an over-usage of younger people now using off-site gambling sites and underground poker sites because we in fact have prohibited it and not required that poker sites have this type of technology. That is the terrible irony involved. More kids are going to gamble that shouldn't be because of this legislation, and we have the responsible way to stop it.

And also with respect to habitual gamblers, the Internet is actually the savior because everything is documented. With a simple look at who is doing what on the Internet, you can figure out who are the problem gamblers, prohibit them from gambling, and get them help. You put it underground, you do it off-shore, they are going to lose the same amount of money, if not more, and you won't get them any help, and none of it goes taxed.

Mr. CONYERS. Thank you very much.

The Chair recognizes the gentleman from North Carolina, the senior Member of the Judiciary Committee, Howard Coble.

Mr. COBLE. Thank you, Mr. Chairman.

It is good to have you all with us. Mr. Chairman, some years ago, Merle Haggard, a country balladeer, recorded a song entitled "The Kentucky Gambler." And the concluding lyrics were these words: "But a gambler loses much more than he wins." Now, Ms. Duke would be an exception to that, but I would be inclined to think that the number of losers far exceeds the number of exceptions.

Ms. Hanaway, Internet gambling cases are complicated for several reasons, not the least of which is because most of the facts deal with electronic transactions. If the law was changed and Internet gambling became regulated, how would this impact your ability to investigate and prosecute Internet gambling cases?

Ms. HANAWAY. Congressman, you are absolutely correct that these are very complex cases. Each of these cases, like BetonSports or NetTeller, in each of those the defendants were gigantic organizations. We heard testimony earlier from Congressman Goodlatte that the prosecution of NetTeller alone closed down the payment of \$6 billion a year—that is \$6 billion with a “b.” In BetonSports, we alleged that it was \$1 billion per year being bet.

So whether these prosecutions involve illegal gambling or legal gambling, we are still talking about a magnitude of transactions that will require enormous amounts of investigation and I am not certain that a change in the law other than bringing some of those records on-shore would make a significant difference in those prosecutions.

Mr. COBLE. Thank you for that.

Professor, would the United States have jurisdiction to prosecute an off-shore gambling website?

Mr. WEILER. I have to answer, it depends, complicated rules about extraterritorial jurisdiction. Just as we would not like some far away country to prosecute legal activity in our country, other countries do not like us to prosecute what is legal activity in their countries. So there are complicated rules about that.

But Congressman, the burden of my testimony was not the jurisdictional issue, because simply saying that under the commitment the United States took within the World Trade Organization, the activity which is being prosecuted is protected. It should not be prosecuted independently of the jurisdictional issue. I am sorry I can’t answer more fully.

Mr. COBLE. That is good enough. Thank you, sir.

Mr. McClusky, Internet gambling is regulated and permitted in Europe. What impact has this had upon their society, if you know?

Mr. MCCLUSKY. The study I cited in my testimony was a British study where it is regulated, and it showed that even under regulation that online addiction to gambling online has risen just as much as it has become popular over there. So even regulation has not helped those who have become addicted online.

Mr. COBLE. Professor, let me come back to you again. I think you may have touched on this earlier. Trade has had an enormous impact upon the district I represent and upon other districts as well, some good, some bad. I represent several industries that rely very obviously on international trade. What impact will the WTO decisions have and what industries will be affected, if you know?

Mr. WEILER. Each decision of the WTO is germane to the industry at hand. I will give you an example. The United States brought a case against Japan which was discriminating in the way they taxed alcohol. They found an ingenious scheme that had a low tax on Japanese alcohol and a high tax on our bourbon, et cetera.

The United States representative in the WTO very, very forcefully said to Japan, “You undertook when you signed onto the WTO that decisions of the appellate body should be complied with uncon-

ditionally. Please comply.” And Japan complied. I think it is in the interest of this country that the decisions of the appellate body of the WTO on which there is always an American judge, should be complied with when we win and when we lose.

Mr. COBLE. Mr. Chairman, if I may ask one more quick question to the U.S. attorney, Ms. Hanaway.

Ms. Hanaway, have any Internet gambling sites been linked to money laundering? I don’t know the answer. I am wondering if that has come across your desk.

Ms. HANAWAY. There have been some cases, Congressman, that have been linked to money laundering, but it has been to date within the context of laundering proceeds of gambling. It hasn’t been proceeds from other illegal activities that were laundered through these Internet gambling companies.

Mr. COBLE. I see my time has expired.

Mr. Chairman, I yield back. Thank you.

Mr. CONYERS. You are welcome.

The Chairman of the Crime Subcommittee, Bobby Scott of Virginia.

Mr. SCOTT. Thank you very much.

Ms. Duke, you are representing the Poker Players Alliance. We have heard today a suggestion that online gambling can lead to bankruptcy, divorce, domestic violence, child abuse, crime and imprisonment, and raising children who are at an increased risk of smoking, drinking, drug use and becoming pathological gamblers.

Can you comment on that, especially pointing out what most people gamble in an average Friday night poker game?

Ms. DUKE. Absolutely. I appreciate the question. Since some Members of the Committee feel that bringing up anecdotal evidence is important in determining legislation, I would like to point out that none of my four children smoke or drink; none of them play poker or have any interest in playing poker whatsoever, or engage in any other forms of gambling. So far, I am not bankrupt, and I certainly don’t abuse my children. So I guess that I am the piece of counter-evidence that you can now base the legislation on.

But most people who gamble online, it has been determined, spend \$10 a week doing so, which where I live wouldn’t even get you into a movie. These are these people’s recreational dollars, and I feel that they should be able to choose to spend those recreational dollars and discretionary money as they so please.

We can find anecdotal evidence of people harming their families, again as I said before, from any activity that you might engage in, and not just activities that we seek to regulate like, for example, alcohol, but activities that we seek not to regulate like shopping, for example.

One would hope that because anecdotally we have people making very bad decisions for which Internet gambling is certainly not the cause, but a symptom of the issues in those families that we wouldn’t be legislating on that. At least I would hope that. That is my understanding of how the law works, so I certainly appreciate the opportunity to be able to re-state those beliefs.

Mr. SCOTT. Thank you.

Ms. Hanaway, we have heard a lot about the prohibition against Internet gambling. Isn’t it true that Internet gambling in the Fed-

eral code, it is not illegal to gamble on the Internet? It is illegal to run a gambling operation?

Ms. HANAWAY. It is illegal to engage in the business of taking bets or wagers.

Mr. SCOTT. But not illegal—there is no prohibition against gambling on the Internet?

Ms. HANAWAY. That is correct.

Mr. SCOTT. Okay. Now, if the site is located outside of the jurisdiction of the United States, particularly in some low country that we don't have diplomatic relations with, how would you restrict someone's ability to gamble on that Internet site under present law?

Ms. HANAWAY. Well, the position that we have taken is that they are using wires that are contained within the United States to either transmit the funds or to transmit the information upon which they are placing the bets.

Mr. SCOTT. And how would you get jurisdiction? How would you prosecute the case?

Ms. HANAWAY. Well, the best example I can give you is the case that is in our own jurisdiction, which is BetonSports, where the corporation subjected itself to our jurisdiction, even though it was a corporation domiciled in Great Britain.

Mr. SCOTT. That is a country we have good diplomatic relations with. How about a country we do not have diplomatic relations with? Is there any way to reach them effectively with the Internet?

Ms. HANAWAY. It makes it much more difficult.

Mr. SCOTT. Ms. Abend, how would a bank know that a specific transaction involves unlawful Internet gambling if the payee is an escrow account or a hotel that has a casino and online gaming?

Ms. ABEND. Congressman, thank you for your question as regards the various types of payment systems that can be used and the specific example I think that you are talking about. In the event that, for example, under our current proposed rule, someone was to use a credit card to make some kind of deposit, the proposed rule outlines policies and procedures that are reasonably designed. As one of the non-exclusionary examples in that—

Mr. SCOTT. How would a bank know what the purpose of the transaction was? How would the bank know that it is unlawful Internet gambling, if all they have is the payee's name?

Ms. ABEND. Well, in the example that you are providing to me, Congressman, the merchant account agreement with the credit card company is required to have due diligence processes and procedures to know the kind of activity that that business that they are creating that merchant account agreement with is in, what kind of activity they are conducting. In the example that you are using, if it is for the purpose that that account is being used for the purpose of unlawful Internet gambling, then—

Mr. SCOTT. How would the bank know, if it is a hotel in Monte Carlo?

Ms. ABEND. Congressman, as part of the requirements for credit cards, credit card companies when a bank establishes a merchant account agreement, that is a financial institution, with a business for them to be able to process credit card payments, there is a due

diligence requirement for them to be able to know whether or not it is processing illegal online gambling.

Mr. SCOTT. But if it is a hotel in Monte Carlo, they could have hotel expenses. That is not illegal.

Ms. ABEND. Congressman, you raise a very good point.

Mr. SCOTT. It could be legal casino transactions.

Ms. ABEND. Congressman, you raise a very good point. It is something that the Treasury in consultation with the Department of Justice and the Federal Reserve Board spent a lot of time focusing on during our deliberations—the idea that payments could be commingled for lawful or unlawful activity. And so what we did in our proposed rule is we outlined what we think are reasonably designed policies and procedures for them to monitor whether those types of accounts are being used for illegal activity.

Mr. SCOTT. Do you have any jurisdiction over foreign banks if somebody were to open a bank account in a foreign bank? Would you have any jurisdiction over that?

Ms. ABEND. Congressman, to the extent that the financial institution is overseas, the statute does not provide authority for us.

Mr. SCOTT. Mr. Chairman, if I could ask one question to Mr. Colopy. You can verify age. Can you technologically verify location, where the person is located as they are gambling on the Internet?

Mr. COLOPY. Yes. In most cases, yes.

Mr. SCOTT. So if a State were to legalize it, you could technologically ascertain that they were in fact in Nevada?

Mr. COLOPY. Yes. For example, right now the New York state lottery, it does not sell tickets beyond its borders. We process for them, and those are verified.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. CONYERS. Thank you very much.

The Chair recognizes acting Ranking Member, Bob Goodlatte of Virginia.

Mr. GOODLATTE. Thank you, Mr. Chairman. There are a lot of things that need to be touched on here.

First, I would like to suggest that while this is a wonderful panel and everybody has made a good contribution, you might want to consider having an entire panel of State attorneys general and governors. The reason I suggest that is that that is really what the heart of this issue is all about. What the Federal Government has generally done has been related to helping the States enforce their laws.

Ms. Duke has correctly noted that our Federal law, which is over 40 years old, the Wire Act, is out of date. Mr. Wexler incorrectly noted that last year we passed legislation—I wish you were here to hear this—but that we passed legislation last year to correct that. I wish that we had. This Committee worked very hard on that legislation. We passed it out, and as has been already noted, it passed the House by an overwhelming margin. But I went to the Senate and pleaded with the Senators to take that. They only took the financial services portion of the bill.

So all of this discussion about what the Congress has done recently needs to focus on the fact that the only thing that Congress has done—here he is—the only thing that Congress has done is to pass legislation related to the transfer of funds. We have changed

no laws related to what is lawful and what is not lawful for gambling.

Now, in the United States, other than horse racing, which I will be happy to discuss, there are no activities operating outside of States where Internet gambling is taking place. The reason for that is very simple. If the State of New York sells lottery tickets over the line in Connecticut, they will hear from the Connecticut attorney general. Oh, and you know what? They have already heard from the Connecticut attorney general, who has challenged what New York is doing, because the technology is far from perfect.

MySpace, on a totally different issue, was asked to address this issue of keeping minors from being exposed to people of other ages on MySpace sites. And as of yesterday, when we contacted MySpace, they again told us that it was impossible to verify the age of their users with accuracy. Yes, there are programs that do this, and I know Aristotle is a leader in that area, but at the Financial Services Committee hearing there was another witness who testified that these technologies have error rates upwards of 20 percent to 30 percent.

And when it comes to determining location, the problem is even greater. The reason is that with a hand-held device, you simply do not know where that person is at all times. If they want to pass that device on to somebody in another State to participate in this, that is something that I don't know that the technology can counter.

So what we are left with, then, is what we have always had with regard to gambling. And that is that this is primarily something that is regulated by the States. The reason why very few States have attempted to do anything online is because they can be sued and indeed prosecuted by neighboring States. Utah, which has no legal gambling, sits next to Nevada, which has all manner of legal gambling. There are no Nevada businesses that are engaged in this.

So this then takes us to the WTO situation that Professor Weiler complains about. That goes back almost 20 years to the negotiations for the Uruguay Round of the WTO. And the language is a very obscure phrase called "other recreational services." Isn't that correct, Professor Weiler? The language that was the basis for Antigua bringing a case against the United States—I will yield to you in a minute, Professor Weiler. Let me lay this out and then you can respond, if the Chairman will allow me.

Other recreational services—the determination was made that that encompassed gambling. Now, at that time, there was no Internet gambling that anybody contemplated, and most, not all, but most people involved with those negotiations, and certainly the current representatives of U.S. trade, have maintained that it was never our intention to take something that is primarily regulated by the States and trade it away internationally. But nonetheless, as Professor Weiler has correctly noted, the dispute resolution panel determined that "other recreational services" encompassed gambling and that the United States was in violation of the trade agreement.

So given the quandary that we have, so then on the appeal it was determined that because there is horse racing that takes place

in the United States, betting online, and the Justice Department for whatever reason has chosen not to begin any direct prosecutions in that area, although Ms. Hanaway correctly notes that it is a part of some of the other prosecutions they have been involved with, that issue remains unresolved.

And so, the U.S. trade representative, without action by the Justice Department, is forced to deal with the fact that, as correctly noted, that there is this one activity going on in the United States.

Mr. WEXLER. Would the gentleman yield?

Mr. GOODLATTE. No, let me finish, and then I am going to yield to Mr. Weiler, and then I will be happy to take the matter further.

So the U.S. trade representative, given the fact that this is widely regarded in the United States, even the Chairman noted at the outset, as a morals issue, and not something to be dealt with in terms of international trade, determined to withdraw it. Now, when you withdraw something from the WTO, that is not a small matter by any means. So when you do that, you then have a determination made of what kind of damages should be paid to do that.

Well, one of the things that I hope they look at is the fact that nobody contemplated the dramatic explosion of Internet gambling when that agreement was made many, many years ago. So certainly, people who entered into the agreement were not seriously harmed by that.

And secondly, you should look to what it is that they are being denied the opportunity to do. Horse racing—I don't see Antigua saying that they have big plans to engage in horse racing. No, it is casino gambling. It is poker. It is all of these others things that they are engaged in.

So that process has to work its way through, and they are now in the process of discussing this. Many of the countries have settled with the United States, but the European Union has not and Antigua has not. I think it is very important that the Congress not interfere with that process as it works its way through and as it is resolved.

I think it is also important that the Congress not interfere with the fact that we have just now written regulations that relate to a new mechanism for enforcement in terms of the transfer of these monies outside of the country. But that is what is in my opinion the crux of this matter, what the States' interests are and how our government will resolve this difference with the WTO.

Now, Mr. Weiler, my time has expired, but if the Chairman will allow, I certainly hope that he will feel free to respond.

Mr. WEXLER. Mr. Chairman, could I just add 30 seconds to Mr. Goodlatte's point, which was raised as to the state of the law in reference to my legislation and so forth, if I may?

Mr. Goodlatte says that the bill that was previously passed didn't in effect change the state of the law. I introduced H.R. 2610, which would permit Americans to play games of skill like poker, backgammon, mahjong, online as I believe they have every right to do.

The issue is, contrary respectfully to what Mr. Goodlatte says, is the Department of Justice is with us today, and the Department of Justice is saying that the Wire Act, which the controlling case says should only apply to sports betting, not poker, the Wire Act

is not supposed to be applied to poker under the Fifth Circuit case, the Department of Justice tells us, "Oh, no, it does."

So that is where I would respectfully differ with your statement as to the law.

Mr. GOODLATTE. Well, reclaiming my time, don't forget what the primary emphasis of my remarks was that you also have 50 State laws. And when you go online, and Utah doesn't want any gambling in Utah, there is not, notwithstanding Mr. Colopy's claim, any State that has so far determined that it is going to offer these services online because they do not have the confidence that they can keep it from going from one State to another.

I am opposed to having a Federal gaming commission. I think 48 out of 50 State attorneys general would agree with me on that point. That is at the crux of this matter. Is the Federal Government suddenly going to move into the regulation of gambling or not? They have the Wire Act. I would join with you. In fact, at one time I did join with you to attempt to modernize the Wire Act, because I think it should be, but primarily as a tool to help the States regulate and enforce their gaming laws, not to get the Federal Government in as the final arbiter of what is legal and what is not legal in the United States.

Mr. Weiler? Professor Weiler?

If you will permit, Mr. Chairman?

Mr. WEILER. Thank you, Mr. Chairman.

Thank you, Mr. Goodlatte.

I want to remind the Committee that I really express no opinion on the desirability otherwise of gambling as such. I just want to——

Mr. CONYERS. It is okay if you want to. [Laughter.]

Mr. WEILER. I don't. But I want to clarify the position of the WTO. The phrase in question is "recreational, cultural and sporting services." And that was found to cover remote betting. It is not 20 years ago, Congressman. It is from back in 1995.

Now, there are two areas where probably you and I will eventually agree to disagree. Let us assume that the United States indeed found that it gave a commitment that it discovered later that it covered something that it did not want covered—remote betting. It goes before the dispute settlement, which it itself set up and supports, and it loses. And it goes to appeal and it loses. And it is illegal. And it signed onto an agreement which says that once the appellate body speaks, the members will comply unconditionally.

One thing that is troubling me, and I think may trouble this Committee, and is troubling many people around the world is why in the face of that are these criminal prosecutions continuing? Once you resolve the issue for the future, you criminalize it, but when individuals are engaged in activities that the United States has held to have committed to be free, that is what is troubling. We have a self-interest in that, because what we do today might be done to our citizens tomorrow.

Mr. GOODLATTE. Professor Weiler, would your answer be the same if it were cocaine from Colombia? If it were shoulder-fired missiles from another country? If the mistake we made that allowed the importation of an unlawful product in the United States——

Mr. WEILER. But that is exactly the point I make in my written testimony, Congressman. Sometimes on vital national interests like national security, we come against an international obligation. We are seeing it. You know what I am talking about. And we say because it is a vital national interest, our own existence, we are very sorry, we just have to follow our national interest.

But this is not national security. And we should be sparing. We are the most powerful state in the world. We must be sparing when we violate international legal obligations. This is not cocaine. There is no vital national interest. That is the first point.

The second point is the WTO was hospitable to the moral argument. The appellate body under article 14 of the GATS, it says public morality is an excuse, a legitimate excuse. What they could not understand is how the United States could come in and say we want a justification to prohibit remote betting from WTO members, when in the United States, I read from the ruling, it has been found that there is substantial and even prominent businesses with collectively thousands of employees and apparently tens of thousands of clients paying taxes or generating revenue for government, having traded openly for up to 30 years and in some cases even operating television channels. The evidence regarding the suppliers demonstrates the existence of a flourishing remote account wagering industry in horse racing in the United States, operating in ostensibly legality. The United States did not—

Mr. GOODLATTE. That is why the United States withdrew from the provision because we have not been able to pass legislation that clarifies this, or to have it resolved in our courts. Barring that, the most sensible thing to do was what the U.S. trade representative did do, which was to withdraw the provision from the agreement.

Mr. WEILER. Understood. But with respect, Congressman, that is indeed why they are doing it, but I wanted to explain why nobody in the WTO bought the moral argument, the cocaine argument, because if a country said it is immoral to do this kind of remote betting, but not another kind, it simply was not persuasive. And the way the withdrawal is being perceived, they are withdrawing so they can continue to engage in protectionism, to protect a domestic industry which is allowed to remotely wager and not allow an outside supplier.

So I understand that on this you and I will probably agree to disagree, but those are the two issues which a lot of people find troubling and are risky for our long-term interests in the world trade arena.

Mr. CONYERS. The Committee will stand in recess.

Ms. JACKSON LEE. Mr. Chairman, can I just get a quick question in, because I will not be able to return? I really would appreciate it.

Mr. CONYERS. Absolutely not. I am sorry, with all due respect to my esteemed colleague, but we have how many minutes left?

Ms. JACKSON LEE. We have 3 minutes, but we have a bunch of minutes.

Mr. CONYERS. The leader just lectured us about closing off the vote.

We will stand in recess. You are welcome to go back into the Committee room and debate or discuss among the witnesses what

your final advice is going to be for us this afternoon when we return.

[Recess.]

Mr. CONYERS. The Committee will come to order.

The Chair recognizes the distinguished gentlelady from Texas, Sheila Jackson Lee.

Ms. JACKSON LEE. Thank you very much, Mr. Chairman.

I thank the witnesses. For those whose testimony I have not heard, I apologize for being in a number of hearings as Members tend to be.

I did hear the discourse with the distinguished gentleman, and I am attempting to find your name, because I don't think you were sitting in the appropriate seat, but I think you are now. At a fairly high pitch, which I think is appropriate, you spoke about this in the context of national security, particularly as it relates to our trade agreements.

I frankly believe you have made a very valuable point, because many of us who have taken issue with the WTO have really fought around issues of survival, whether or not it was the survival of the Caribbean as it relates to the banana trade, taking a different perspective for them to survive, or whether it was around issues that truly relate to national security, international travel. We really have stood our ground and in that instance been in conflict with, for example, the WTO.

But you raise an important point as to whether this raises to this level of prominence. So my line of questioning goes along those lines, because I am trying to find a reasoned position here. My good friend from Virginia, who is not here, knows that at one point I found merit in his arguments.

I have since had a different perspective because I think there is such a debate over the use of the Internet and online activities that you do have to begin to distinguish life or death matters or matters of high morality, if you will, that have a general embrace by most of America, such as the enticing of children over the Internet for sexual activities. I don't think there is vast disagreement on that issue. Most of us would go to the line, if you will, on eliminating that practice.

On the other hand, when you speak about gambling, you have the old nightmares of addressing the question of the most vulnerable, and particularly sometimes in my community, that are the victims. But they are the victims possibly of the lottery and a number of other enticing activities. So it is a social responsibility, maybe a faith-based responsibility, to be able to address those concerns so that people can responsibly manage their concerns.

But in this instance, and I raise my question first to Ms. Duke, because I do think that the Frank bill, the Barney Frank bill, is reasonable. My question to you very directly is, with your degrees and your choices, help me understand, and my time is short, so let me just say quickly, whether or not this bar on your practice or your avocation is effective? And whether or not since this bill has occurred, whether you have seen an increase in your membership? And whether or not we are really getting where we want to get with this ban, as opposed to it being a ban on livelihood, income and opportunity?

Ms. Duke?

Ms. DUKE. Thank you for the opportunity to answer your question. The fact is that people are engaging playing poker online regardless of whether the UIGEA exists. All we are doing is having them engage on it with foreign operators and foreign payment processors.

So believe me, it was difficult to get money online before, regardless of this legislation. PayPal ceased to allow money transfers to be made somewhere around 2002, I believe, 2001 or 2002. It was pretty early in the process. Credit cards have denied gaming transactions when they are coded for gaming transactions for a very long time. So people have always had to sue off-shore payment processors.

Now, NetTeller, to be sure, has been shut down, but there are lots of other payment processors out there that people can use. So in a regulated environment, we would be much better served—

Ms. JACKSON LEE. Such as the Frank bill?

Ms. DUKE. Such as the Frank bill, in order to determine people who should be—

Ms. JACKSON LEE. What about the morality question? I am sorry my time is so short, but what about the morality question?

Ms. DUKE. Sure. The issue that I have on the morality question, meaning no disrespect to Mr. Goodlatte, is that I personally, as an American, am very offended that we would take a morality stance on gambling. It is legal in 48 States. I don't understand why it would be more immoral to gamble on the Internet than it would be to walk into the Bellagio in Las Vegas and gamble there. If we allow it to be legal in 48 States, I hardly think that this country can take a moral stance on gambling. To pull the morals card as it relates to the Internet is just a new—

Ms. JACKSON LEE. But you would welcome regulations so that scoundrels could not be involved in it?

Ms. DUKE. I don't think that children should be gambling online. My children do not gamble online. I would welcome regulations because I feel that the government would then be able to give me much greater support in enforcing those rules in my household. If I had support from this government, knowing that the sites that were offering gambling in this country were forced to use the kinds of technology that Mr. Colopy has discussed, and that I discussed in regards to a technology like SNARE, I would feel much more comfortable about my children being on the Internet.

Ms. JACKSON LEE. Mr. Chairman, would you indulge me an additional minute for the Justice Department representative to answer this question? I ask unanimous consent. Thank you, and forgive me for interrupting you, Ms. Duke. My time is short. But I do want to acknowledge—

Ms. DUKE. I appreciate the time that you gave me. Thank you.

Ms. JACKSON LEE. Thank you.

I do want to acknowledge a letter from the Virgin Islands to express both the detailed way in which they handle their gambling, and the very difficult position we put them in if we were to continue in the way that we are continuing with this bar. But to the Department, have you gone after—what kind of prosecutions have

you engaged in to get the scoundrels off of poker playing or Internet gambling?

If we had not had this bar, would this be an issue that you would be out championing? Do you have a Department staffed up with a task force that is going after these scoundrels, the alleged scoundrels, if this is such a horrible act? What kind of work are you doing to weed out these individuals? And what kind of work were you doing before this law came into place?

Ms. HANAWAY. Congresswoman, I have cited several cases today, including the *United States v. NetTeller* or the *United States v. Uvari*, the *United States v. BetonSports*, that are prosecutions under the law that existed before the UIGEA. So those are prosecutions primarily under the Wire Act.

Ms. JACKSON LEE. And under what mindset? What were you operating under at that time?

Ms. HANAWAY. Under the Wire Act that was passed in the 1960's, and updates to it.

Ms. JACKSON LEE. And you saw the value? What was the problem that you were trying to go after?

Ms. HANAWAY. Illegal Internet gambling, the fact that those companies were violating the laws as they existed.

Ms. JACKSON LEE. But you could not—basically, it was just a Plain Jane law. You were not seeing major cartels or scandals or people dying and being in shoot-outs.

Ms. HANAWAY. Well, there was a great deal of money being transmitted outside of the United States. The allegations in BetonSports—

Ms. JACKSON LEE. So if this law that Mr. Frank has is in place, that would stop the money going outside the United States, would it not? Would it not?

Ms. HANAWAY. I can't say that it would with certainty, because—

Ms. JACKSON LEE. But his framework is to prevent money from going outside the United States and regulate them.

Ms. HANAWAY. Right now, all of these companies are violating the laws of the United States—

Ms. JACKSON LEE. But the laws might change.

Ms. HANAWAY [continuing]. By taking those bets.

Ms. JACKSON LEE. Right. But if the laws were changed?

Ms. HANAWAY. And they are off-shore. I don't know that making it legal for those others to operate on-shore in the U.S. would make them disappear overnight. I can't say with any degree of certainty that they would stop violating the law. They are violating the law today.

Ms. JACKSON LEE. But a regulation would at least put a population who would abide by the law and give you the opportunity with our task force or your go-getters to be able to know who are the bad guys, and you would still have a framework for sending money back to the United States. You would abide by the law, though, would you not?

Ms. HANAWAY. Of course. We would enforce the law.

Ms. JACKSON LEE. I thank you, Mr. Chairman.

I yield back.

Mr. CONYERS. I thank the gentlelady.

And the Chair recognizes Steve Cohen of Tennessee, one of our newer Members, but highly concerned. He has been here at the hearing almost all day.

Mr. COHEN. Thank you, thank you, Mr. Chairman.

First, I would like to ask the panel, does anybody know the countries in Europe where they have permitted Internet gambling? Mr. Colopy, do you know? Any other countries other than the U.K?

Mr. COLOPY. There are several. I couldn't list them for you.

Mr. COHEN. Does anybody else know which countries they are? Ms. Duke?

Ms. DUKE. I may be mistaken. I just want to say that, but I believe that the U.K., Germany, Sweden, Finland—

Mr. COHEN. That is enough. Does anybody know if there have been any studies in any of those countries other than England? Nobody knows of any studies. Does anybody know if divorce, bankruptcies, suicides, mass exoduses, scurvy have occurred in those countries other than England?

Ms. DUKE. Actually, the rate that those have occurred in England is quite low. The U.K. gambling prevalence study which was just completed, the last study was completed in 1999, which was at the front edge of Internet gambling when it wasn't particularly prevalent.

Mr. COHEN. Thank you, Ms. Duke. Do you have a study to rely on?

Ms. DUKE. The U.K. gambling prevalence study.

Mr. COHEN. Is that the same study Mr. McClusky, you cited?

Mr. MCCLUSKY. Yes, it is.

Mr. COHEN. And you said that it cited that there was a low amount of addiction or high-use for people playing the lottery and horse racing, et cetera, but higher for Internet gambling? Is that correct?

Mr. MCCLUSKY. That is correct.

Mr. COHEN. But when Congressman Wexler asked you something about horse racing, you said that you would look into prohibiting horse racing. So you really think horse racing is wrong, too, and you should look into making that illegal?

Mr. MCCLUSKY. That would be something I said that we would be willing to talk with Mr. Wexler if he was serious about including such an exemption, if he was afraid that it was going to—

Mr. COHEN. Do you think that horse racing and dog racing and lotteries should be legal in the United States?

Mr. MCCLUSKY. Are you asking me?

Mr. COHEN. Yes, you personally.

Mr. MCCLUSKY. The Family Research Council does believe that such things should be illegal.

Mr. COHEN. Should be legal?

Mr. MCCLUSKY. Should be illegal.

Mr. COHEN. Should be illegal. So it is really not the Internet you are against. It is gambling in general. Is that right?

Mr. MCCLUSKY. Yes, that would be true, or at least unrestricted gambling such as we have with the Internet or other.

Mr. COHEN. But the lottery is restricted. You can't play if you are a child. Same thing with horse racing. But you are against that, are you not?

Mr. McCLUSKY. Yes.

Mr. COHEN. So restricted or unrestricted, you are against it?

Mr. McCLUSKY. Yes.

Mr. COHEN. Is there any fun that you are for?

Mr. McCLUSKY. Any what?

Mr. COHEN. Fun.

Mr. McCLUSKY. Well, we are for this, and this seems like a lot of fun.

Mr. COHEN. Hearings? Good, good. [Laughter.]

Let me ask Ms. Hanaway a question. Were you in Missouri when they had the referendums on lottery and casino gaming?

Ms. HANAWAY. I was.

Mr. COHEN. And was it predicted there that all these awful things would occur? That the river would go all the way back to Cairo, that the Cardinals would leave, and that Busch Stadium would no longer exist?

Ms. HANAWAY. There were some predictions that it would have ill-effects, but none of those precisely as you describe.

Mr. COHEN. They talked about divorce rates going up, that bankruptcies would increase, all those kind of things, didn't they?

Ms. HANAWAY. I believe so.

Mr. COHEN. That is the standard litany. I sponsored and passed the lottery in Tennessee. They said all those things would occur. None of them occurred. In fact, what happened is we have raised \$1 billion for education, and the most avaricious group tried to get into the lottery program to get scholarships were the faith-based schools, who wanted more money for the private than the public, or equal to, when they at first were only going to be half as much.

And then they wanted exemption after exemption for home schoolers, for people on missions, which I went ahead with and agreed with, and said "fine, no problem, they are kids and they are fine." But there was a little bit of hypocrisy because they were so much against it, and then they were the first people at the trough. And that is a problem that I think Mr. McClusky your group has, when you come and you predict the end of the earth and it doesn't occur, then the next time it is a little bit like Chicken Little, you know, the sky is still up there and that is a problem.

Mr. McCLUSKY. I couldn't speak for Tennessee, but in most States where they have pushed for a lottery under the guise that it would promote for education, that has simply just not happened.

Mr. COHEN. I understand that in most States. Tennessee is different. We followed the Georgia model. It is all the new revenue with the scholarships. It is to after-school programs. It is to before-school programs. It has been a great success. It is all monies they wouldn't otherwise have. So that is that case.

Let me ask you this. Who did that study in Europe you are talking about, in England? Do you know who did the study?

Mr. McCLUSKY. It was published by the National Center for Social Research.

Mr. COHEN. Is that a private group or public group?

Mr. McCLUSKY. Actually, I am not sure about that.

Mr. COHEN. Okay. You have to always look at who does the study and who they are being paid for or by. Is anybody familiar with the lines that they publish in the newspaper of what the

point-spreads are on the basketball games and the football games? Do you think there is any booking going on in America? I mean, they don't put that in for recreational activity. There are some people looking at it.

Let me ask Ms. Abend, did the Department of Treasury ever do an estimate on how much revenue the IRS could realize if we had chosen to license and regulate Internet gaming from the beginning, how much money we could have brought into the United States?

Has there been a study at either Treasury or somebody at Justice on how much money could be raised for schools and health care and other issues like that if we regulated this?

Ms. ABEND. Not that I am aware of.

Mr. COHEN. Okay. What would be wrong—to the panel—what would be wrong with a simple study? What is wrong with a study? Mr. McClusky, what is wrong with a study?

Mr. MCCLUSKY. Well, it would depend on what the study was calling for. As I mentioned before in my testimony, Congress already called for a study back in 1999 and released that study.

Mr. COHEN. Was that Fahrenkopf? What was his name? What was that study on?

Mr. MCCLUSKY. It was on gambling, except it also included Internet. It looked at Internet gambling.

Mr. COHEN. I think I know that study. The deck was stacked. No offense, Ms. Duke. It does happen.

Ms. Abend, would the Department of Justice provide the Treasury Department with written comments or input prior to the release of the regulations that have developed?

Ms. ABEND. Congressman, yes.

Mr. COHEN. Would you be willing to provide us with a copy of those?

Ms. ABEND. Congressman, I will be happy to meet with you and your staff and work with you on that.

Mr. COHEN. Well, let me defer to Chairman Conyers. If you would meet with Chairman Conyers and his staff, because he has the power of contempt. If you don't bring them, you will be brought in and be flogged. [Laughter.]

Thank you, though. Thank you. I appreciate your bringing them in.

I think my time is up, and with that, thank you, Mr. Chairman.

Mr. CONYERS. Thank you very much.

Trent Franks, the gentleman from Arizona, the Ranking Member on the Constitution Committee.

Mr. FRANKS. Well, thank you, Mr. Chairman.

First, Mr. Chairman, I think that Ms. Hanaway and Mr. McClusky have pretty much articulated my perspective both legally and in policy terms of the subject that we are talking about today. I think with all of the citing of statistics, that most people understand in their heart no matter how intellectually good they are at presenting a statistical analysis, that gambling in general in our republic has tended to damage the lives of people. That certainly has been our experience in Arizona, especially on some of the reservations where they have had wide-scale casino gambling. It has been a negative impact on people.

When you look at Las Vegas, you see some mighty nice hotels and some beautiful lights. Something is paying for that, and I would suggest that it is the disparate proportion of the winners and losers. Gambling essentially produces one thing, and that is the loss on the part of someone. That is the only way that it survives as an industry is by someone else's loss.

As far as it producing much for society, other than what some might point to as entertainment, even though there might be some ancillary jobs created, the overall productivity of gambling is the loss and the negative impact on someone's life.

As far as America, the professor indicated somehow our reputation has been damaged because we did what we could to protect our families and children from the effect of gambling, somehow I think we will survive it.

With that, Mr. Chairman, I would like to yield to Mr. Goodlatte for the remainder of my time.

Mr. GOODLATTE. I thank the gentleman for yielding.

I would like to revisit this issue with regard to the States. Ms. Duke, did I hear you correctly say that you felt that the residents of each individual State should have the right to determine what kind of gambling they want to have in their State?

Ms. DUKE. You incorrectly heard me.

Mr. GOODLATTE. What is your position on that?

Ms. DUKE. My position is that for anyone to take a moral stance as far as the WTO is concerned on gambling, to me is hypocritical. That would only imply that there is a difference as far as the morality of gambling on the Internet versus gambling in an actual casino, and the fact that in 48 States gambling in some form or other is completely legal. I would assume, then, if you are taking the moral stance, Mr. Goodlatte, that you are planning to be on gambling in any form whatsoever and illegalize it across the country in order to remain consistent in your opinion.

Mr. GOODLATTE. No. My opinion is consistent that each State should be able to determine what form of gambling should be allowed.

Ms. DUKE. Absolutely. I agree.

Mr. GOODLATTE. Well, that is what I was trying to get at. Well, that being the case, then, how does that square for the people of Utah with the WTO decision? Should they change their lives to allow gambling online in Utah?

Ms. DUKE. Mr. Frank's bill includes an opt-out for individual States. So for individual States where gambling is illegal, they could opt out of the Frank bill or not, if it gets passed into law, and not offer Internet gaming in those States, and we would still be compliant with the WTO. Now, certainly if all 50 States pass those laws, we would still be in compliance with the WTO, but that is not the case right now.

Mr. GOODLATTE. Sure, it is not. That is the whole point of the legislation that was passed, to enable individual States to enforce their laws regarding the laws that they have in those States.

Ms. DUKE. But I would respectfully submit that they would be able to do that under Mr. Frank's legislation as well.

Mr. GOODLATTE. Except that you would be creating a Federal regulatory system which would tax the gambling in all those States that did not choose to opt out of that.

Ms. DUKE. Absolutely, but in those States where it would already be legal, and rightly so we should tax it because we should be getting the revenue from it as opposed to having the revenue go offshore.

Mr. GOODLATTE. And what about the States where you cannot determine whether or not somebody is actually in that State when they place that bet?

Ms. DUKE. Well, we have very good software, and MySpace actually has not talked to, for example, Iovation, which offers the SNARE software, and if they did, they would feel much more comfortable in terms of being able to verify where somebody was from. There is absolutely software out there, whether MySpace has explored those thoroughly or not is not particularly germane to whether the software exists.

Mr. GOODLATTE. Well, certainly we can continue that debate.

Ms. DUKE. Absolutely.

Mr. GOODLATTE. The legislation that the Congress did not pass last year would have allowed the States to continue to regulate gambling within those States. But the fact of the matter is, that is the current law as it exists today, and very few States have attempted to do anything like that. New York may be the only exception to that.

Ms. DUKE. But under a regulatory environment, the sites would be forced to use those kinds of software and would be actually much more effective in terms of getting people in place where it is not legal to gamble—

Mr. GOODLATTE. Why shouldn't the State—

Ms. DUKE [continuing]. Or minors for that matter.

Mr. GOODLATTE. Why shouldn't the State make that decision, Ms. Duke?

Ms. DUKE. Well, it wouldn't be about the State, though.

Mr. GOODLATTE. That is right. That is the whole crux of the debate isn't it? It is about whether States have the right to do this or the Federal Government has the right to do this.

Ms. DUKE. Gambling sites that were offering services in America would be forced to use the software in terms of verification of location and majority. In a regulated environment, we will be more effective at getting people who are in States where it is illegal not to gamble, and frankly getting minors because the sites will be forced to use this software.

It doesn't have to do with the States. It has to do with the people offering the services. It is not the State that determines whether someone can buy alcohol. It is the liquor store, because they are forced to verify by a form as an ID, and this would be exactly the same thing, except using the extremely advanced software technology that we have at our fingertips now, and that Mr. Colopy has testified about.

Mr. GOODLATTE. Ms. Duke, let me interrupt you. The point here is not whether or not the States can or should do that. We don't disagree with you on that point. The question is whether the Federal Government should set up a Federal regulatory system that it

has never done before which would enable it to impose taxes to derive revenues that have been the province of the States.

Some States said "we don't want those revenues; we want to have no gambling in our State." Utah and Hawaii have chosen to do that. Others States like mine have said, well, we will have limited forms of gambling, but we don't want any casinos in our State. Each State ought to have the right to do that, and you agree with me on that point. So why not leave the regulation to the States?

Ms. DUKE. But Mr. Frank agrees with that as well.

Mr. GOODLATTE. Sure, but he sets up a Federal Government commission, and if anybody believes "we are from the Federal Government and we are here to help you, and all we are going to do is help the States out in terms of having a Federal system that enables the Federal Government to engage in taxation, that enables the Federal Government to engage in overriding the decisions of the States on those," I hate to disabuse you.

Ms. DUKE. But the Federal Government under the UIGEA will do exactly that because it has been clearly stated that the banks are going to over-block and not allow people who are in States where what they are engaging in is legal engage in that activity.

Mr. GOODLATTE. Only where the activity is in violation of State law or it goes across State borders. Absolutely.

Ms. DUKE. They have said very clearly that they would over-block. They are already blocking bridge transactions and test transactions.

Mr. GOODLATTE. Mr. Chairman?

Ms. DUKE. They are conservative institutions. You are asking them to interpret the law, but they will interpret it in a way that will cause them to over-block, and you are asking, indeed, the Federal Government to tell the banks to say what you can and cannot do in a State where a—

Mr. GOODLATTE. That is because none of these offshore sites, and every single one of the sites that we are talking about here are outside the United States. Every single one of them is engaged in activities that are not regulated by the States, and in fact couldn't be regulated by the States.

So the fact of the matter is that the effort that we have made in the Congress to clarify the right of the States, like Tennessee, to have the kind of gambling they want to have in Tennessee, as long as they keep it confined within their borders and do not allow minors to participate, is permissible. That was permissible under the bill that passed through this Committee, passed the House of Representatives, but was not taken up by the United States Senate.

What we don't need is to have the Federal Government go beyond that and usurp the power of the States by saying that we are going to have a Federal gaming commission to regulate gambling on the Internet.

Ms. DUKE. Then I would like to hear why you supported a bill like the UIGEA that allowed interstate betting like horse racing and fantasy sports.

Mr. GOODLATTE. Well, first of all, fantasy sports I have not heard anybody claim is a form of betting. Now, the fact of the matter is—I am serious.

Ms. DUKE. I am sorry. Yes, it is.

Mr. GOODLATTE. We allow minors to participate in those programs. You have all said to me that it is a very great concern, and I agree with you it is a great concern that we not allow minors to engage in gambling, but nobody has said we should stop minors from participating in fantasy sports. So I think there is a very clear difference there than what you have just described.

But the fact of the matter is that I would like to have a ban on all interstate transactions with regard to betting. I would support any legislation that did that, but I will also support any legislation that goes as far as I can possibly take it to go, and that is exactly what the legislation we passed is. But the UIGEA takes no position whatsoever on what is legal and what is illegal.

It simply is a new tool for enforcement that is being utilized by the Justice Department, the Treasury Department and I am sure many, many State government agencies who are concerned about the loss of revenues that they have when this money starts going outside of the country, as it had been doing, and much of it has been curtailed because of the enforcement that the Justice Department has done and State law enforcement entities have done to make sure that they can continue to enforce their State laws.

Mr. CONYERS. The Chair recognizes for the few minutes we have remaining the gentleman from Tennessee, Steve Cohen.

Mr. COHEN. Thank you, Mr. Chairman.

First, I would like to, if there is any misunderstanding with Ms. Abend, I didn't mean to suggest in any way you would be like Harriet Miers and not comply, but I would appreciate it if you would give to the Chairman and also give to me copies of that study. That would be appreciated. I would like to have it as well. Thank you.

Let me ask Mr. Colopy, you have in England the ability to stop minors from playing on the Internet?

Mr. COLOPY. Yes, and here.

Mr. COHEN. And do you know that study? Do you know any fallacies in that study? Or is the system not working?

Mr. COLOPY. Let me clarify. In the U.K. where gaming is legal, yes, we are one of the age verification systems used. I think we had a principal on that.

Mr. COHEN. And if Mr. McClusky's study is correct, is there a problem with the verification system? Or could the study be—

Mr. COLOPY. There is no problem with the effectiveness of it, and that is the only thing I can address. Aristotle takes no position on the merits or demerits of Internet gambling or gaming. What we are here to address is to knock out the fallacy that children cannot be protected online, as was incorrectly suggested earlier.

Mr. COHEN. I know when we had the lottery in Tennessee, they brought up a study and they said that children were gambling and all these different things. And once we got the study, we found out they were gambling on flipping, on marbles, different things that had nothing to do with the lottery. So it really wasn't relevant.

Do you have the ability—like if I have a laptop and I go to Montana and I wanted to bet on something in Montana—to know that I was a Tennessean and to tax me in Tennessee? How do you do that?

Mr. COLOPY. In my statement, thanks to some very intelligent engineers, I have described in layman's language what the IP location does. I can't elaborate on it more than that, but would be happy to provide you with much more information.

Mr. COHEN. I am beyond a layman. The IP location, is that where I live or where my laptop is?

Mr. COLOPY. It is connected to your Internet address.

Mr. COHEN. My Internet, so that is where I am domiciled. Could I get an Internet address somewhere other than where I live? Could I get an IP in Arkansas or in West Memphis if I lived in Memphis?

Mr. COLOPY. Well, if you use multiple ones, unless the system were allowed to, you would be anchored to the one you originally registered with. The other thing to remember is, it is anchored to your legally registered address because it has to be a real person. We are talking about verification. We are talking about measurement against public records data, so you couldn't reinvent yourself in multiple locations.

Mr. COHEN. Okay. I would yield back the remainder of my time and thank the Chairman for allowing me.

Mr. CONYERS. I yield to the gentleman from Virginia for insertions into the record.

Mr. GOODLATTE. Thank you, Mr. Chairman.

I would just ask that the letter of the National Association of Attorneys General, signed by 48 attorneys general and dated March 21, 2006 pertaining to the legislation that the Congress addressed last year, along with a more recent letter signed by the Attorney General of Maryland and the Attorney General of Florida, dated September 28 of this year, be put in the record, along with a letter dated May 31 of this year from all of the major sports organizations—NFL, major league baseball, NBA, NHL, and the NCAA—also be put in the record.

Mr. CONYERS. Without objection, so ordered.

[The information referred to follows:]

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Executive Director

March 21, 2006

PRESIDENT
STEPHEN CARTER
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PRESIDENT-ELECT
THURBERT BAKER
Attorney General of Georgia

VICE PRESIDENT
LAWRENCE WADEN
Attorney General of Idaho

IMMEDIATE PAST PRESIDENT
WILLIAM H. SOBRELL
Attorney General of Vermont

Via Facsimile

The Honorable J. Dennis Hastert, Speaker
United States House of Representatives
H-232, The Capitol
Washington, DC 20515

The Honorable Nancy Pelosi, Minority Leader
United States House of Representatives
H-204, The Capitol
Washington, D.C. 20515

The Honorable Bill Frist, Majority Leader
United States Senate
S-230, The Capitol
Washington, DC 20510

The Honorable Harry Reid, Minority Leader
United States Senate
S-321, The Capitol
Washington, DC 20510

We, the undersigned Attorneys General, wish to express our strong support for the efforts of the 109th Congress to pass legislation seeking to combat illegal Internet gambling in the United States. While we do not support federal preemption of our state laws related to the control of gambling, Internet gambling transcends state and jurisdictional boundaries and requires that all segments of the law enforcement community (state, federal and local) work together to combat its spread.

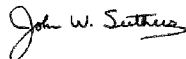
NAAG has historically supported federal efforts to clarify federal prohibitions on Internet gambling. As we stated in a similar letter in 1999, gambling laws and regulations have more state-to-state variety than almost any other area of law. For example, gambling policies range from the absolute prohibition of any gambling, as found in the States of Utah and Hawaii, to full casino gaming as allowed in Nevada and Atlantic City, New Jersey. The myriad of regulatory schemes related to gambling is constructed within the framework of each jurisdiction's moral, law enforcement, consumer protection and revenue concerns. Most jurisdictions believe that they have established the most appropriate combination of law and policy to address their own population's needs and desires.

Internet gambling is a threat to this carefully crafted system. Moreover, the potential problems associated with the availability of gambling activities on the Internet are exacerbated because the inability of technology to reliably guard against many of the same hazards that led to the policy considerations used by jurisdictions to construct their

gambling regulations. These policy considerations include moral attitudes towards gaming, issues of game integrity, effective consumer dispute resolution procedures, access to gambling by minors, cash controls to hinder money laundering and other criminal activity, as well as efforts to recognize and treat problem gamblers.

We encourage the United States Congress to help combat the skirting of state gambling regulations by enacting legislation which would address Internet gambling, while at the same time ensuring that the authority to set overall gambling regulations and policy remains where it has traditionally been most effective: at the state level.

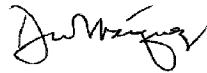
Sincerely,



John Suthers
Attorney General of Colorado



Troy King
Attorney General of Alabama



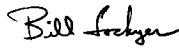
David Márquez
Attorney General of Alaska



Terry Goddard
Attorney General of Arizona



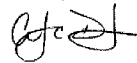
Mike Beebe
Attorney General of Arkansas



Bill Lockyer
Attorney General of California



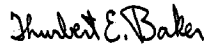
Richard Blumenthal
Attorney General of Connecticut



Carl Danberg
Attorney General of Delaware



Charlie Crist
Attorney General of Florida



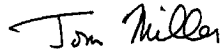
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Mark J. Bennett
Attorney General of Hawaii



Lisa Madigan
Attorney General of Illinois



Tom Miller
Attorney General of Iowa



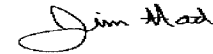
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Attorney General of Louisiana



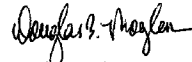
J. Joseph Curran, Jr.
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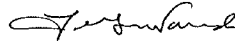
Mike Cox
Attorney General of Michigan



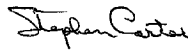
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Douglas Moylan
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Lawrence Wasden
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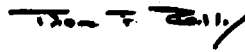
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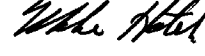
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G. Steven Rowe
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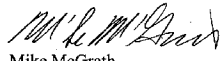
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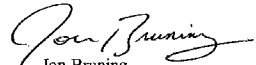



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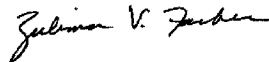



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Mike McGrath
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Jon Bruning
Attorney General of Nebraska

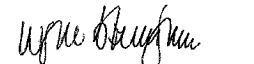

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Zulima V. Farber
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Patricia A. Madrid
Attorney General of New Mexico



Eliot Spitzer
Attorney General of New York

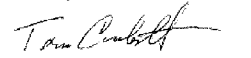

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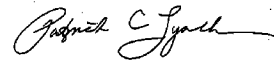

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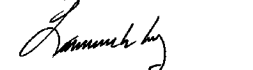

W. A. Drew Edmondson
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Tom Corbett
Attorney General of Pennsylvania


Patrick Lynch
Attorney General of Rhode Island

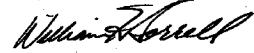

Henry McMaster
Attorney General of South Carolina


Lawrence Long
Attorney General of South Dakota

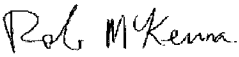

Paul G. Summers
Attorney General of Tennessee



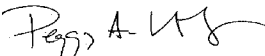
Greg Abbott
Attorney General of Texas



William H. Sorrell
Attorney General of Vermont



Rob McKenna
Attorney General of Washington



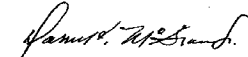
Peg Lautenschlager
Attorney General of Wisconsin



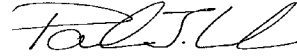
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Robert McDonnell
Attorney General of Virginia



Darrell McGraw, Jr.
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Pat Crank
Attorney General of Wyoming



Attorney General Douglas Gansler
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Attorney General Bill McCollum
PL 01 The Capitol
Tallahassee, Florida 32399

September 28, 2007

Dear Chairman Frank and Ranking Member Bachus,

We, the Attorneys General of our respective States, have grave concerns about H.R. 2046, the "Internet Gambling Regulation and Enforcement Act of 2007." We believe that the bill would undermine States' traditional powers to make and enforce their own gambling laws.

On March 21, 2006, 49 NAAG members wrote to the leadership of Congress:

We encourage the United States Congress to help combat the skirting of state gambling regulations by enacting legislation which would address Internet gambling, while at the same time ensuring that the authority to set overall gambling regulations and policy remains where it has traditionally been most effective: at the state level.

Congress responded by enacting the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA), which has effectively driven many illicit gambling operators from the American marketplace.

But now, less than a year later, H.R. 2046 proposes to do the opposite, by replacing state regulations with a federal licensing program that would permit Internet gambling companies to do business with U.S. customers. The Department of the Treasury would alone decide who would receive federal licenses and whether the licensees were complying with their terms. This would represent the first time in history that the federal government would be responsible for issuing gambling licenses.

A federal license would supersede any state enforcement action, because § 5387 in H.R. 2046 would grant an affirmative defense against any prosecution or enforcement action under any Federal or State law to any person who possesses a valid license and complies with the requirements of H.R. 2046. This divestment of state gambling enforcement power is sweeping and unprecedented.

The bill would legalize Internet gambling in each State, unless the Governor clearly specifies existing state restrictions barring Internet gambling in whole or in part. On that basis, a State may "opt out" of legalization for all Internet gambling or certain types of gambling. However, the opt-out for *types* of gambling does not clearly preserve the right of States to place *conditions* on legal types of gambling. Thus, for example, if the State permits poker in licensed card rooms, but only between 10 a.m. and midnight, and the amount wagered cannot exceed \$100 per day and the participants must be 21 or older, the federal law might nevertheless allow 18-year-olds in that State to wager much larger amounts on poker around the clock.

Furthermore, the opt-outs may prove illusory. They will likely be challenged before the World Trade Organization. The World Trade Organization has already shown itself to be hostile to U.S. restrictions on Internet gambling. If it strikes down state opt-outs as unduly restrictive of trade, the way will be open to the greatest expansion of legalized gambling in American history and near total preemption of State laws restricting Internet gambling.

H.R. 2046 effectively nationalizes America's gambling laws on the Internet, "harmonizing" the law for the benefit of foreign gambling operations that were defying our laws for years, at least until UIGEA was enacted. We therefore oppose this proposal, and any other proposal that hinders the right of States to prohibit or regulate gambling by their residents.

Sincerely,



Douglas Gansler
Attorney General of Maryland



Bill McCollum
Attorney General of Florida

cc: All Members of the Maryland and Florida delegations



JUN 5 2007

May 31, 2007

JUN 5 2007

Dear Members of the House Financial Services Committee:

On behalf of our respective professional and collegiate sports organizations, we ask for your continued support in protecting American athletics from the corrupting influence of sports gambling.

We wrote to you on April 25, to express our concerns about H.R. 2046, Chairman Frank's Internet gambling bill. Since then, advocates of H.R. 2046 have contended that we have no basis for concern, because H.R. 2046 creates "opt-outs" that permit individual leagues to prohibit gambling on their sports. However, with or without an opt-out, the bill sends a destructive message on how Congress views gambling on professional and college sports. Moreover, we believe that the bill's opt-outs will prove illusory. If H.R. 2046 were to pass, sports betting would likely proliferate and the integrity of American athletics would be compromised.

Congress has historically and consistently opposed sports gambling. In 1992, a bipartisan, overwhelming majority voted to enact PASPA—the Professional and Amateur Sports Protection Act. The House of Representatives' report found that that "there exists a special relationship between American sports fans of all ages and their favorite teams, and that athletic competition embodies and affirms fundamental American values worth protecting from the potential taint of corruption and scandal," and thus "these activities should be declared off limits from further exploitation as State 'revenue enhancers.'"

The Senate report further explained, "Sports gambling threatens to change the nature of sporting events from wholesome entertainment for all ages to devices for gambling. It undermines public confidence in the character of professional and amateur sports. Furthermore, State-sanctioned sports gambling will promote gambling among our Nation's young people." It also concluded that "[t]he moral erosion it produces cannot be limited geographically. Once a State legalizes sports gambling, it will be extremely difficult for other States to resist the lure."

PASPA passed 88 to 5 in the Senate and by voice vote in the House.

Since then, gambling operations—largely based outside of the U.S.—have turned to the Internet, where they were able to evade existing, longstanding gambling laws, including laws against sports gambling. Last year, Congress responded by passing UIGEA—the Unlawful Internet Gambling Enforcement Act—which enhances enforcement of America's gambling laws, including PASPA and other laws against sports gambling.

On July 11, 2006, the House passed UIGEA 317 to 93, reaffirming its commitment to protect American athletics from sports gambling. This strong vote tally reflects majorities of both parties and the affirmative votes of both Leaders.

H.R. 2046 would reverse Congress' longstanding consensus on the harms of sports gambling. Unsupported by any factual record, H.R. 2046 declares that sports betting is acceptable, and the bill expressly authorizes Internet sports gambling. Regardless of the existence of opt-outs, Congress' fundamental message would for the first time be one of approval for sports betting. Moreover, the sports opt-outs are likely to provoke legal challenges in U.S. courts and before the World Trade Organization.

We oppose H.R. 2046 for the following reasons:

- First, the bill states that sports betting is acceptable to Congress.
- Second, the opt-outs are subject to challenge in U.S. courts on the grounds that Congress has unconstitutionally delegated its lawmaking power (to ban Internet gambling) to private parties (commissioners of various sports leagues and conferences).
- Third, the "opt outs" for states and sports leagues are illusory because, if exercised, they might very well be struck down by the WTO as discriminating against foreign providers of gambling services. In that case, the U.S. would be hard pressed to invoke the "public morality" defense to argue, for instance, that offshore internet gambling facilities used by Louisiana citizens corrupt public morals, while Louisiana land based casinos do not, or that sports gambling on football would corrupt public morals, but gambling on boxing or horse racing would not. Consistent with prior WTO rulings, the opt-outs will also prove difficult to defend if Congress gives its consent to Internet sports betting by passing H.R. 2046. Although the United States has announced its intent to withdraw from GATS "commitments" on gambling access, that process will be prolonged and with uncertain outcomes. Thus, the threat of WTO litigation remains active.
- Fourth, H.R. 2046 will lead to demands that PASPA be repealed. The bill would grant greater rights to foreign sports gambling operations, which could conduct Internet sports betting, than to State governments, which would remain barred by PASPA from authorizing sports betting. Arguments to "level the playing field" by repealing PASPA undoubtedly will follow and, once Congress is seen as having endorsed sports betting, will be difficult to resist.

We have long opposed sports betting because of the harm it inflicts on fans of all ages, professional and college athletes, and the integrity of American sports. Congress has long agreed and enforced a policy against sports betting. H.R. 2046 moves in exactly the opposite direction. In doing so, it advances no public interest and simply rewards foreign entities who have shamelessly ignored U.S. law for the past ten years. Accordingly, we urge you to reject it.

Sincerely,

Rick Buchanan, Executive VP and General Counsel
National Basketball Association

Elsa Kircher Cole, General Counsel
National Collegiate Athletic Association

William Daly, Deputy Commissioner
National Hockey League

Tom Ostertag, Senior VP and General Counsel
Major League Baseball

Jeffrey Pash, Executive VP and General Counsel
National Football League

cc: Members of the House of Representatives

Mr. GOODLATTE. Thank you.

Mr. CONYERS. Could I ask Professor Weiler on a closing question. As you know, Philippe Sands has written about the reckless, the lawless world. Familiar? It takes the issue that our government has been in reckless disregard of many of our treaties, conventions, protocols, ranging from anti-nuclear to environmental to torture. There has been a great discussion about how we try to get back on track in a more cooperative spirit since we are one of the most, if not the most influential nation in the family of nations and global organizations.

Can you comment about that tendency and how that dereliction of international responsibility fits into our discussion about Internet gambling and the WTO decision?

Mr. WEILER. Thank you, Mr. Chairman.

Could I just make one tiny comment on the discussion before? We didn't discuss a lot, and it would merit discussion on the States' rights issue that Mr. Goodlatte raised. It would be interesting to explore whether one gave States rights and the technology exists for off-shore WTO members to just offer Internet remote betting in the States that allowed it, what would be the position of the Justice Department?

Now, to your question, Mr. Chairman. I am a realist. If my wife is giving birth, I would drive through a red traffic light and violate the law. I can see circumstances where any State, including the United States, might drive through a red traffic light because their wife was giving birth.

But because of the prominence of this country, and because we lead by example, we lead by example, we should be very, very circumspect in all situations when we decide to disregard the multilateral system, to disregard our international legal obligations.

I do not believe that our legitimate interest in regulating the hazards that come with Internet gambling, even though today we do it in a way that is discriminatory, are such as to justify disobeying, disregarding and violate our international legal obligation. It has a cascading effect.

Yes, the gentleman was right. We will survive it, but when it becomes a cumulative effect, where the impression around the world is that the United States, which preaches the importance of the international system and international law, but when it comes to its own interests replaces might with right, then we should really be very careful.

So Mr. Goodlatte has said, we withdraw our commitment. There is a procedure for that under article 21 with the GATS. Let the procedure run its course, but why, Mr. Goodlatte, and why, Mr. Conyers, would we continue, for example, to prosecute individuals until we have withdrawn our commitment? That is what doesn't make sense to me. And why should we instead of trying to comply with an obligation, we will just withdraw an obligation. Again, if we lead by example, that is not the kind of example which a country like the United States should lead with.

Thank you, Mr. Chairman.

Mr. CONYERS. If you have any further papers or treatises or articles that you may have written about this, because this is an overarching consideration for not only the Judiciary Committee, but the

Foreign Affairs Committee. This is a very large issue that too frequently we have recently noticed that our government has a tendency to walk away, to disengage, to write itself out. Of course, that habit becomes catching with other countries. If we are doing it, why shouldn't they?

So on this note, I thank you all for a very challenging hearing. We are thinking now about following Mr. Goodlatte's suggestion of getting attorneys general of the States, as well as governors and others to weigh in on this, because they have to understand that it is not only their State, but our national laws and our international obligations.

Now, we have heard about the States' rights implications of this legislation. It is clear that there are some that would like to keep the Federal Government out. And there are others who may not have thought clearly about the international aspects as well. All three of these come together on a very fascinating subject. I am so happy that you were all able to spend as much time with us today.

I can assure you this record will be read and re-read by many different people with different points of view. We are obligated and indebted to you for your contribution. Thank you so very much.

The Committee stands adjourned.

[Whereupon, at 2:08 p.m., the Committee was adjourned.]

A P P E N D I X

MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE JIM McDERMOTT, A REPRESENTATIVE IN CONGRESS, FROM THE STATE OF WASHINGTON

Mr. Chairman, thank you for the opportunity to submit written testimony at this hearing. As you are aware, I introduced legislation earlier this year, H.R. 2607, which would provide for the taxation of licensed Internet gambling in the U.S. I introduced this bill not because I am a proponent of Internet gambling—I am not—but because I am not blind to the fact that people will continue to gamble online regardless of any prohibition against it. I therefore believe that the only appropriate, reasoned response is to regulate Internet gambling, so consumers are afforded certain protections and so revenue that would otherwise flow to foreign jurisdictions stays here in the U.S.

My legislation would ensure that for any Internet gambling that occurs in the U.S., all taxes due under federal and state law will be collected—it is a complement to legislation introduced by House Financial Services Chairman Barney Frank (D-MA), which would establish a regulatory regime for licensed Internet gambling. It requires all corporate and personal withholding taxes be collected, but does not impose any additional taxes on U.S. residents. In recent weeks, we have shaped some policy improvements to the legislation that would allow us to provide greater protections against tax cheating relating to online gambling, and thereby increase much-needed revenue. As amended, my legislation, would:

- Impose a fee equal to 2% of deposits placed during the prior 30 days with or on behalf of a licensee for the purposes of wagering.
- Impose a .25% wagering tax on all authorized online gambling (and a 2% wagering tax on all unauthorized online gambling.
- Impose 30% withholding on withdrawals of net winnings by non-U.S. persons.
- Authorize 50 states and DC to impose indirect taxes on licensees with respect to wagers placed by persons within their jurisdictions.
- Require licensees' senior management to reside in the U.S. and computer equipment to be located in the U.S., thereby maximizing availability of corporate taxes.

To be clear, most of the revenues generated would come from taxes required under existing law that we currently lose because of a misguided belief that we can actually stop Internet gambling. Specifically, these are not new taxes, but rather taxes on existing activity that is currently unregulated, unsupervised, and underground. The exception is that my legislation also imposes a fee equal to 2% of deposits placed with a licensed gambling operator. This fee would be paid by the operator, not the individual gambler, and it would help level the playing field for land-based casinos that are concerned about Internet gambling affecting their business. Obviously, the overhead for a land-based casino is greater than that of an online casino, but the 2% fee *on Internet gambling sites only* helps narrow that gap. The provision does not, nor is it intended to, impose any new tax on the operations of land-based casinos. To do so would violate the very purpose of the provision as an equalizer between the land-based and the online industries.

In putting together my legislation, I reviewed various studies and estimates on the amount of Internet gambling that occurs in the U.S. to estimate how much revenue my bill might provide when combined with the proposal by Chairman Frank. In addition, it is my understanding that a private sector analysis was performed to estimate the revenues that would be generated through regulating Internet gambling in the U.S. by adopting legislation based on Chairman Frank's bill and my current proposal. This analysis preliminarily estimates that regulating Internet

gambling would generate between about **\$3.1 billion to \$15.2 billion** in federal revenues during its first five years, and between about **\$8.7 billion to \$42.8 billion** over its first ten years. In fact, assuming that states permit the same gambling activities online as they currently do offline, and assuming the sports leagues opt-out entirely, my proposal would raise about **\$6.3 billion** over five years and **\$17.6 billion** over ten years.

Because the estimates are based on both bills, and Chairman Frank's bill permits individual states and sports leagues to prohibit any Internet gambling, the lower number would reflect a situation in which sports leagues and most states opted-out of the system. The higher number would reflect a situation without opt-outs. Notably, the single largest component of the revenues—more than 50% of the total—would be generated from individuals reporting gambling winnings not captured under the current prohibition regime. The 2% fee on deposits and the 0.25% wager tax would each constitute slightly less than 22% of the total, and the corporate tax on operators would constitute an average of about 5% of the total.

Even under the most conservative estimates, licensing and regulating Internet gambling—and collecting the taxes that are due—will provide much-needed revenue to the U.S. Treasury. This is money we are currently losing to other jurisdictions, for no other reason than some of my colleagues think we can actually stop people from gambling online. It is money we will continue to lose if we ignore the fact that if grown adults in America want to gamble online, they can and they will.

LETTER FROM THE HONORABLE MITCHELL E. DANIELS, JR., GOVERNOR, STATE OF
INDIANA, DATED NOVEMBER 9, 2007



STATE OF INDIANA
OFFICE OF THE GOVERNOR
State House, Second Floor
Indianapolis, Indiana 46204

Mitchell E. Daniels, Jr.
Governor

November 9, 2007

The Honorable Harry Reid
Majority Leader
United States Senate
Washington, D.C. 20510

The Honorable Mitch McConnell
Minority Leader
United States Senate
Washington, D.C. 20510

The Honorable Nancy Pelosi
Speaker
U.S. House of Representatives
Washington, D.C. 20515

The Honorable John Boehner
Minority Leader
U.S. House of Representatives
Washington, D.C. 20515

Re: Internet Gambling Regulation and Enforcement Act of 2007 (H.R. 2046)

Dear Senator Reid, Senator McConnell, Speaker Pelosi and Representative Boehner:

As Governor of the State of Indiana, I wish to express my concerns about a bill currently in the U.S. Congress known as the Internet Gambling Regulation and Enforcement Act of 2007 ("H.R. 2046"), which would legalize Internet gambling and undermine the ability of states to make and enforce their own gambling laws.

In contrast with limited, state-regulated forms of gambling such as horse tracks and riverboat casinos, gambling via the Internet is available from virtually any location (e.g., homes, offices, schools) twenty-four hours per day in an anonymous environment. Research and studies have indicated that Internet gambling is more accessible to minors, more attractive to college-age individuals, more susceptible to fraud and other criminal activity, and harder to regulate. These are some of the reasons why Indiana recently updated its gambling laws to specifically prohibit Internet gambling. Using the Internet to engage in gambling in Indiana, or with a person located in Indiana, is a felony under Indiana law.

Last year, in response to the growth of the Internet gambling problem, Congress passed the Unlawful Internet Gambling Enforcement Act of 2006 ("UIGEA"), which has effectively driven many illicit gambling operators from the U.S. marketplace. But now, less than a year later, H.R. 2046 proposes to do the opposite, by replacing state regulations with a federal licensing program that would permit Internet gambling operators to engage in business with U.S. customers. The Department of Treasury would alone decide who would receive federal licenses and whether the holders of those licenses were complying with their terms. This would represent the first time in history that the federal government would be responsible for issuing gambling licenses.

Furthermore, a federal license under H.R. 2046 would supersede any state enforcement action because, as written, this bill grants a "safe harbor" defense against any prosecution or enforcement under any state or federal law to any person who

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possesses a valid license and complies with the requirements of H.R. 2046. In other words, any gambling operator who obtains a license from the Treasury Department and follows the requirements of H.R. 2046 would be excused from criminal charges.

Essentially, the bill would legalize Internet gambling in each state, unless the governor of a state clearly specifies the existence of a current state restriction (e.g., an existing state law) barring Internet gambling. On that basis, a state may "opt out" of the legalization of Internet gambling or certain types of gambling. However, this opt-out provision is problematic because it does not clearly preserve the right of states to place conditions on legal types of gambling. H.R. 2046 also does not grant Indiana any right to challenge a licensing decision by the Treasury Department or bring an enforcement action against a gambling operator who circumvents Indiana's prohibition on Internet gambling.

In addition, even if Indiana exercises this opt-out and Indiana's ban on Internet gambling remains in effect, the opt-out provision of H.R. 2046 will likely be challenged before the World Trade Organization ("WTO") as a violation of U.S. trade agreements. In recent years, the WTO has ruled against the U.S. in disputes pertaining to free trade in gambling services. Accordingly, if the WTO strikes down the state opt-out provision as unduly restrictive of trade, then it is likely that we will see a significant expansion of legalized gambling in the U.S. and the preemption of state laws prohibiting or restricting Internet gambling.

I ask that you reject H.R. 2046 and any other proposals that would undermine Indiana's ban on Internet gambling.

Sincerely,



Mitchell E. Daniels, Jr.
Governor, State of Indiana

cc: Senator Richard G. Lugar
Senator Evan Bayh
Representative Pete Visclosky
Representative Joe Donnelly
Representative Mark Souder
Representative Steve Buyer
Representative Dan Burton
Representative Mike Pence
Representative Julia Carson
Representative Brad Ellsworth
Representative Baron Hill

PREPARED STATEMENT OF THE HONORABLE L. ERROL CORT, MINISTER OF FINANCE
AND THE ECONOMY, GOVERNMENT OF ANTIGUA AND BARBUDA

**Testimony by the Government of Antigua and Barbuda
Submitted for the House Committee on the Judiciary Hearing on Establishing Consistent
Enforcement Policies in the Context of Online Wagers**

14 November 2007

This testimony is submitted by the Government of Antigua and Barbuda ("Antigua") for the consideration of the House Committee on the Judiciary at its hearing to discuss consistent enforcement policies in the context of online wagering.

The issue of online gambling is of deep interest to Antigua, which has not only invested considerable resources to develop a well-regulated and internationally-recognised remote gaming industry but also has led the fight against the discriminatory trade policies of the United States with respect to remote gambling at the World Trade Organisation. This issue is also of keen interest to our government because Antiguan operators have been heavily targeted by United States authorities in their attempt to destroy foreign competition for gaming services. The three highest profile prosecutions of foreign remote gaming operations brought by United States authorities in the past two years have been brought against operators with Antiguan licensed subsidiaries and substantial Antiguan operations.

Encouraged by the United States to diversify our very limited economy, our small nation of less than 90,000 people set out almost 15 years ago to develop trade in the cross-border provision of gambling and betting services. Using the then-novel technology of the Internet, Antiguan service providers became the acknowledged leaders in this industry, resulting in much-needed diversity to our economy, interesting and demanding employment for our young people and in-flow of increasingly significant amounts of money to our country. Many will no doubt be surprised to learn that as late as 1997, the United States government was cooperating with our remote gaming regulatory team, providing guidance and assistance on how to ensure fairness and reliability to American consumers of the gaming services offered by Antigua.

Without warning, this all changed in 1998 with federal indictments of a number of Antiguan operators for providing the very same services that—just shortly prior to the release of the indictments—the United States Department of Justice had publicly stated were not covered by American laws. Since that day, our industry has been under continuous siege from the United States authorities with further indictments of Antiguan citizens and operators, seizures of international funds on order of the United States government, strong-arm tactics aimed at banks and credit card companies to dissuade them from furnishing services to offshore gaming operators and culminating with last year's "Unlawful Internet Gambling Enforcement Act."

Cognizant that these efforts by the United States were contrary to its International legal obligations, in early 2003 Antigua sought consultations with the United States under the dispute

settlement mechanism of the World Trade Organisation. Whereas we approached those consultations with an aim to discussing our legal differences and encouraging some kind of middle ground settlement, we soon found out that the United States had no interest in doing so. Ultimately, facing no alternative we filed a complaint with the WTO over the United States' breach of its International treaty obligations. As most know by now, we defeated the United States at the WTO, which has issued its recommendation to the United States government that it come into compliance with the WTO agreements. To date, this has not occurred, and Antiguan operators remain subject to even harsher United States efforts to prevent the offering of services to consumers in the United States—this despite such efforts being finally and judicially resolved to be illegal under a binding, International treaty to which the United States is a party.

During the course of the WTO proceeding, the United States asserted that it was entitled to prohibit the provision of remote gambling services on the basis that remote gambling *per se* is so pernicious and subject to unacceptable risks that it *must* be prohibited—that it is indeed such an awful activity that the United States had to and did prohibit *all* remote gambling activity. The problem is, that this is not the truth. In fact, as the UIGEA so eloquently illustrates, what the United States does do is prohibit most (but certainly not all) remote gambling that crosses a border while leaving states free to allow, prohibit or regulate remote gambling activities within their own borders as they may see fit. Now, if “remote” gambling is so bad that it cannot be regulated and must be prohibited, then why does the United States permit it in *any* form? Why, if the United States government has decided that it must prosecute Antiguan who—as they are entitled to do under International law—offer regulated remote gambling services, in order to protect the “morality” of American citizens, does the United States government not require every state to prohibit remote gambling as well?

The reason is, as the WTO has recognised, that the United States' “prohibition” is really simply a disguised restriction on trade. The United States allows a flourishing domestic remote gambling industry, but is applying criminal sanctions to Antiguan for doing the exact same thing. As has become increasingly clear during the course of our WTO dispute, in fact Antigua has been *too* successful in its development of this industry. There is too much money to be made in this industry, apparently, for the United States government to allow Antigua the prosperity that this industry was on the cusp of delivering to our tiny country. Antigua, it seems, should be satisfied with “steady growth” of its economy.

We are aware of all of the claims that Internet gambling is a haven for abuse by addicts, organised crime, terrorists, children and others. We have heard of the examples of lives ruined and other horror stories. But the reality is that in its almost 15-year history, these fears commonly associated with Internet gambling have not been realised. Internet gambling has not proven to be any more problematic than any other type of discretionary activity that may be subject to abuse—in fact, we supplied plenty of evidence to the WTO demonstrating that “bricks-and-mortar” gambling is highly subject to *all* of the “ills” that have been alleged (but not proven) to be endemic to remote gambling.

In Antigua, we have dedicated substantial resources to the development, regulation and oversight of our industry. We know our operators, most of the principals of which live on our small island. We have long experience in the regulation of the industry. We know that our services are fair and responsible. We have offered to the United States government the opportunity to jointly regulate our industry, to exercise some kind of joint oversight, to study our relatively mature gaming industry to establish—as we expect such a study would—that responsible remote gaming is not only possible, but is being offered by service providers from Antigua today.

Unfortunately, despite our repeated outreach and despite the unambiguous rulings of the World Trade Organisation, the United States not only refuses to engage with us in a cooperative manner but continues to exert every effort to destroy our industry.

We applaud the efforts of Representatives Berkley and Frank to take a more responsible approach to Internet gambling. In fact, we have proposed to the United States administration—to its silence—that the mature and diverse Antiguan industry could serve as an excellent test case for the responsible and independent assessment of remote gambling under the ambit of the Berkley bill. As Representative Frank does, we believe that remote gambling is here to stay and that at some point in the near future, the United States will have to deal with the issue in a comprehensive manner. While we think that as currently proposed, Representative Frank's legislation will not bring the United States into compliance with the WTO decision in our favour, we are engaging with the Congressman to find ways to make it so.

Not only is Antigua entitled under International law to offer responsible gaming services to consumers in the United States, but it is the right thing for the United States to allow it to do so. The World Trade Organisation is either a fair and level playing field for all global participants or it is a one-way street for the big economies to spread their economic power across the world. As the smallest country to ever avail itself of the WTO dispute resolution process and to have won, against all odds, against the world's only remaining superpower, Antigua seeks only what it is entitled to. Clearly, the United States enjoys the WTO dispute mechanism to enforce the trade obligations of other countries to the United States. We believe it is imperative that the United States respect the rule of International trade law and we look forward to the continued leadership on this issue from the United States Congress.

Honourable L. Errol Cort
Minister of Finance and the Economy

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PREPARED STATEMENT OF CRAIG POUNCEY, PARTNER,
HERBERT SMITH LLP (BRUSSELS)

TESTIMONY OF

CRAIG POUNCEY, PARTNER,
HERBERT SMITH LLP (BRUSSELS)

ON

ESTABLISHING CONSISTENT ENFORCEMENT POLICIES IN THE CONTEXT OF
ONLINE WAGERS

BEFORE

THE U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON THE JUDICIARY

Mr. Chairman and Distinguished Members of the Committee

Introduction

I am Craig Pouncey, a partner in the Brussels office of UK law firm Herbert Smith, and head of my Firm's international trade law practice. In that capacity, I have had the opportunity to work on the case between Antigua and the United States, in which the WTO found that a number of U.S. laws violate the General Agreement on Trade in Services ("GATS") because they prohibit the supply of Internet gaming services from jurisdictions outside the U.S.

I do not currently represent Antigua but act for a number of EU companies with an interest in the gaming sector.

In this testimony, I will explain the role of the WTO in the Internet gambling debate and the different options that the U.S. has in the WTO, following its loss in the Antigua case.

General background and the Antigua dispute

The GATS, which is the relevant WTO Treaty here, works on an "opt in" basis. This means that key obligations only apply to the extent that a country has "opted in" for a specific sector (or, in GATS language, made "specific commitments"). In the case brought by Antigua, the Appellate Body of the WTO found that the U.S. had made "specific commitments" with regard to the cross-border supply of gambling and betting services. As a result, the U.S. had to provide "market access" to the suppliers of such services from other WTO member countries. The Appellate Body went on to find that the U.S. violates that obligation because several federal laws prohibit the use of the Internet to supply gaming services from foreign jurisdictions to consumers in the U.S.

By way of defence, the U.S. had invoked an exemption clause that allows a country to depart from its normal WTO obligations (*i.e.* in this case to prohibit access to Internet gaming services from countries such as Antigua) because of the need to protect public morals. The U.S. argued that Internet gambling posed uncontrollable risks of youth gambling,

fraud and money laundering. This defence failed, however, because the U.S. allows Internet betting on horse races.

The U.S. was given until April 3, 2006 to comply with the findings of the Appellate Body Report. On July 6, 2006 Antigua convened a WTO "compliance Panel" to assess the steps taken by the U.S. to comply with the Appellate Body's findings. The U.S. used these proceedings, *inter alia*, to reargue its case that Internet gambling cannot be regulated and that Internet horse race betting was not lawful in the U.S. The U.S. lost the argument again and, on March 30, 2007, the latest WTO report in this saga was issued. In the context of this debate, the most interesting points of this most recent WTO Report are the following:

- The WTO Panel found that "there are at least 18 State laws that expressly authorize wagering by wire within the United States, including on a wholly intrastate basis".
- The WTO Panel states that, while the U.S. originally argued that Internet gambling could not be regulated, it has changed its position because the Unlawful Internet Gambling Enforcement Act 2006 explicitly acknowledges that such regulation is possible.
- The WTO Panel refers to the recent prosecution of foreign Internet gaming operators but adds that it finds it "striking" that the DOJ has never prosecuted any of the U.S. based operators of Internet horse race betting.
- The WTO Panel notes that the U.S. had an opportunity to clarify that Internet gambling on horse race betting is prohibited but that the Unlawful Internet Gaming Enforcement Act does precisely the opposite by deliberately maintaining the ambiguity.

The U.S. decided not to appeal this latest WTO report, which, therefore, became final.

Option 1 for the U.S.: withdrawal of commitments

On May 4, 2007, the USTR announced that the U.S. would start a procedure to withdraw the U.S. commitment on gambling and betting services. Pursuant to this procedure, all WTO Members, not just Antigua, are entitled to claim compensation from

the U.S. Such compensation normally adopts the form of additional trade liberalisation in other areas. This procedure has never been used in a context such as the one at issue here and the U.S. move is generally perceived as an attempt unilaterally to change the WTO contract after losing the legal fight. On 22 June 2007, WTO members announced their intent to negotiate compensation with the US¹.

The USTR press release announcing the withdrawal of the GATS commitment mentioned that, in its view, other WTO Members have "very little, if any" basis to claim compensation because the U.S. made the commitment on gambling by mistake.

Other WTO Members do not share the U.S. view on this matter. First of all, they find it difficult to believe that the U.S., which was the main driver of the GATS negotiations during the original negotiations, was unable to understand its own commitments.

Further, it should be noted that the U.S. has requested, obtained, and used the right to impose countermeasures in a WTO dispute settlement case where such a "misunderstanding" had effectively occurred. In the well known *Bananas* dispute between the U.S. and the EU, the U.S. argued that the activities of U.S. companies such as Chiquita were "banana distribution services" covered by the GATS and the EU's GATS commitment on "distribution services".

The EU disagreed. In fact, the EU had taken a series of measures to protect its banana regime from being challenged in the WTO but it had never considered that its commitment on "distribution services" could have been used against its regime for the importation of bananas. If the EU had realised this, it would no doubt have excluded "banana distribution services" from its commitment on "distribution services". However, the EU had not done that and thus lost the dispute with the U.S. The U.S. then obtained the right to impose painful economic sanctions on the EU for a total value of USD 191.4 million per year. This caused very serious hardship to the EU companies targeted by those sanctions and, in at least one case that I am aware of, it caused bankruptcy. The total amount of these sanctions related to a lack of compliance with GATS obligations which the EU never intended to make.

¹ EU (on behalf of its 27 Member States), Antigua, Australia, Canada, Costa Rica, India, Japan and Macao.

The same U.S. that requested, obtained, and applied these economic sanctions *vis-à-vis* the EU is now claiming that it can withdraw commitments without compensation, or with only limited compensation, because *it* did not intend to make these commitments. In my view this is wrong as a matter of law: the US gaming market (both territorial and on-line) is worth an estimated \$100 billion. This represents a sizeable "brick" in the wall of world trading opportunities and it is uncontroversial to suggest that it should in principle be replaced by a "brick" of similar size and substance. As mentioned, a number of WTO member countries, including the EU (which negotiates on behalf of its 27 member states), have asked to negotiate with the US and the time-frame for those negotiation has already been extended twice because of the inadequacy of the US offers for replacements market access. EU Trade Commissioner Peter Mandelson has already announced publicly that compensation is due and that the numbers "need to be substantial". I believe that the U.S. will be asked, as a result, to open up other markets which will be of substantial value to its trading partners. This will be the price that the U.S. has to pay to avoid option 2, *i.e.* regulation of Internet gambling.

Option 2 for the U.S.: regulation of Internet gambling

Appropriate regulation of Internet gambling would put the U.S. on a road to resolving the WTO problem. The U.S. would avoid having to offer possibly substantial compensation in the form of opening new markets to foreign competition, and, as a result, affecting possibly numerous other economic players in the US who have absolutely nothing to do with gambling, or the WTO gambling dispute. Further, rather than losing credibility, the U.S. would strengthen the WTO and its legal system, which the U.S. wants other countries, and in particular China, to respect. This is, again, the solution publicly favoured by the EU. As Peter Mandelson said in Washington on 8 November, "What we need to see is a change in US legislation that removes that discrimination against EU operators [...] it is not in the interest of American consumers to have good responsible competitors in this market excluded by regulatory mechanisms".

Thank you, Mr. Chairman and Distinguished Member of this Committee for considering this testimony and I would be happy to answer any questions that you may have.

PREPARED STATEMENT OF JOHN LYONS, GROUP SECURITY ADVISOR, UC GROUP

Mr. Chairman and Members of the Committee:

My name is John Lyons. I am Group Security Advisor to the British payments services provider UC Group, where I am responsible to the Board for advising on all matters relating to risk and security and for relations with law enforcement agencies.

I am also Coordinator for the Corporate Executive Programme, an organisation comprising some of the world's largest global enterprises including Intel, HSBC, Diageo and Mitsubishi UFJ—established by FIRST (the Forum of Incident Response & Security Teams) to provide advice upon the implementation of global risk strategies. During my time as an employee of the UK government I served as the UK's Crime Reduction Coordinator at the National Hi Tech Crime Unit (NHTCU).

I am pleased to provide the Committee this written testimony to address the issue of online wagering from a security and law enforcement agency perspective relating to the security and integrity of online financial systems.

SUMMARY

The question has been raised whether the prohibition of Internet gambling is necessary to protect consumers from various risks linked to Internet gambling, in particular, the risks of compulsive gambling, underage gambling, money laundering and fraud.

As the Committee considers whether the current U.S. regime of prohibition is being effectively enforced, it should also consider the fact that there exist technological solutions today which could be adopted to bring a very high degree of safe and secure practice/s to online financial transactions, including those relating to Internet gambling. Such solutions will protect not only the consumers but also the integrity of the financial infrastructure that they are using to facilitate Internet gambling transactions today.

Implementation of such solutions is not only possible in connection with regulating Internet gambling, but is necessary in the broader context of the online payments system. Indeed, if we fail to act promptly to strengthen our ability to secure online financial systems, we face the prospect of organised crime and terrorism gaining more and more funding from innocent consumers—whilst banks and credit card schemes positioned in the middle, act as unwitting facilitators.

INTERNET GAMBLING REGULATION PROMOTES INTERNET SECURITY

There is a pressing need to respond proactively before customer confidence is diminished irretrievably, the integrity of the financial systems is challenged and before governments, legislators and regulators are forced to react to mitigate the potential damage by bringing the online financial industry into line. This threat pertains to all sectors utilizing online financial transactions and not just to the Internet gambling industry. Many informed sources and experts in this arena take the view that we are presently losing the battle in the online space to organised criminal and terrorist groups (sometimes referred to as 'non-state actors') and to hostile foreign governments. Ironically, the very steps needed to create a secure regime that protects consumers in the area of Internet gambling are needed in any case to protect the Internet overall from this array of threats.

The basic principles of actions that need to be taken to protect the payments system generally, and to provide for consumer protections in the area of Internet gambling, are by now well documented. They include:

Authentication and Identity Management—proving beyond reasonable doubt that the person conducting the transaction is who they purport to be.

Authorization—proving that the identified person is the authorized user of the credit/debit card or other financial instrument being used in the transaction.

Age Verification—a second layer of security and process sitting behind the items mentioned above, and which may require persons to verify their date of birth before access can be granted to goods and/or services online.

User Location—certain services offered online may require that a user's location is identified. In some cases this might merely mean by country, but in other cases the service may require location verification to county/state level or better.¹ Often, the various obstacles which can be placed in the way of tech-

¹ Currently Internet Service Providers (ISPs) are very often able to provide this service retrospectively in response to authorised requests from law enforcement and security agencies. How-

nically verifying location data cause concern to many. However, the online merchant, operator and financial services company, can, based on the level of transactional risk involved and the nature of the service, decide to decline the transaction in cases where the location cannot satisfactorily be confirmed (for whatever reason).

Data Sharing on Criminal Activity—every company in the online financial transaction chain holds data relating to criminal activity and attempted activity. Sharing this data throughout the financial 'supply chain' would provide increased levels of assurance in authorizing online transactions whilst providing a significant weapon in the fight against online fraud. In addition, the ability to provide industry reporting of such criminal activity to government and to law enforcement and security agencies would significantly enhance their ability to prevent and investigate online crime.

Two Factor Authentication—The operators involved in certain high risk categories of online transaction, such as travel, gambling, electrical goods and international transactions, could provide their online customers with a second tier authentication token to provide increased levels of assurance and security. Distributed in a secure way to users, this would provide a high degree of certainty of identity, authority and age. Indeed, one might ask why the issuing banks which provide credit and debit cards for use online, do not offer this service now.

REGULATION AND ENFORCEMENT

Currently, law enforcement agencies benefit from the open interaction they have with financial services companies and payment providers who provide services to a broad range of e-commerce merchants. A flow of information and intelligence exists from many of these companies, which provides law enforcement with a greater understanding of the nature of new criminal *modus operandi* in online transactions. In cases where law enforcement agencies choose to investigate online criminality, having the ability as law enforcement officers to sit down and meet with all regulated Internet gambling companies and their payment service providers, banks and credit card companies provide an enormous boost to the ability to fight e-crime.

AN EXAMPLE OF REGULATION AND ENFORCEMENT WORKING

Whilst serving as the UK's Crime Reduction Coordinator at the National Hi Tech Crime Unit (NHTCU), now a part of the UK's Serious Organised Crime Agency (SOCA), I had responsibility, *inter alia*, for ensuring that law enforcement, the financial industry and online businesses worked closely together in the fight against e-crime. During the period 2003 to 2004, organised crime groups based in Russia, were orchestrating sophisticated Distributed Denial of Service (DDOS) attacks against Internet gambling companies. These attacks, using netbots—thousands of compromised PCs with broadband connections around the world—brought down many Internet gambling companies. In essence, they were taken off the Internet and rendered unable to function.

In some cases, these DDOS attacks succeeded in taking hundreds of other businesses off the Internet, because they were connected to the same Internet Service Provider.

Once these attacks had succeeded, the organised crime group, made contact with the Internet gambling companies demanding various payments before the attack would be terminated. This was nothing less than extortion.

In the face of this organised crime onslaught, a number of Internet gambling companies called on the assistance of the NHTCU.

The NHTCU subsequently held a round table meeting with 19 Internet gambling companies represented by their CEOs, Chief Technology Officers and in some cases with their finance chiefs.

The companies were encouraged not to pay up—since by doing so, they would almost certainly have broken money laundering laws and assisted criminal activity. From the meeting, NHTCU assembled a wealth of evidence and technical data, launched an investigation and subsequently worked for many months with law enforcement officials in Latvia, Lithuania, Belarus and then Russia—where the UK Foreign Secretary of the day discussed with the Russian President, Mr Putin, the need for law enforcement cooperation—which was successfully secured.

ever, real time analysis is what is needed and ISPs should be invited to provide solutions for commercial use.

By contrast, many unregulated Internet gambling companies in off shore locations were also subjected to DDOS attacks—they simply paid up and continued to do so in the face of further attacks, thus facilitating the success of organized crime.

During the subsequent investigation, which has since come to a successful conclusion, the NHTCU discovered a huge amount of material and evidence to not only assist the DDOS/Extortion investigation, but which also provided evidence that these same organised criminal groups were behind a vast global network of other online criminal activities. These included “phishing” attacks against the USA, Canada, Australia and the UK. It included evidence of massive credit card theft and fraud, the sale of technical exploits and malicious code online to the highest bidders, the control of netbot armies comprising tens of thousands of compromised PCs and servers, the counterfeiting of national identity documents and driving licences, on-line paedophilia, website defacement—the list was endless, the organisation was superb! The same organised crime groups were involved in many of these activities, and no doubt continue to be so.

NEGATIVE CONSEQUENCES OF PROHIBITION

My point is Mr Chairman, without the ability to reach out, meet, discuss and share information with legitimately regulated companies trading in Internet gambling, law enforcement will find it hugely difficult to bring satisfactory resolutions to investigations. Without regulation of Internet gambling businesses, they will find it enormously difficult to introduce preventative measures to block criminal activities before they succeed.

Without putting in place a robust regulatory regime which introduces the safeguards outlined earlier in my testimony, the entire online sector (not only Internet gambling operations) will continue to be at the mercy of organised criminal groups and will continue to be a source of terrorist funding. In short, if you regulate an industry and thereby establish security standards, you are able to protect that industry, the consumers who use it, and the infrastructure it uses at the same time. Thus, the regulation of Internet gambling not only has a protective impact on consumers engaging in the gambling activities, but on the Internet itself, just as putting security standards in place for financial institutions and the payments system strengthens a wide array of online protections.

In my opinion, prohibition of Internet gambling in the USA creates a substantial risk of having huge amounts of U.S. persons’ currency getting into the hands of criminal groups. Such groups move into unregulated markets, and a prohibition model is in practice just that—a market that is not regulated in practice, because there are no standards that govern it. Operators taking bets from U.S. persons must today operate in the shadows, and that means in the absence of oversight. The result is that unscrupulous alternative payment mechanisms hooked up with unregulated Internet gambling sites off-shore are filling their pockets with untaxed earnings. Located in the shadows, these operators are able to avoid meaningful US enforcement. Publicly traded Internet gambling companies, regulated by internationally recognized regulators, are no longer doing Internet gambling business with the United States. Their hidden counterparts operating where they cannot be seen continue to do so. The passage of the Unlawful Internet Gambling Enforcement Act 2006 thus has had the unintended consequence of helping those over whom the U.S. has the least information, the least oversight and the least capacity to control.

ADDRESSING THE SOCIAL PROBLEMS

Underage gambling, compulsive gambling, involvement of organized crime, money laundering and fraud are areas of public concern and are not unique to the United States but faced by a multitude of jurisdictions. Many jurisdictions, including the United Kingdom, have legalized Internet gambling. They have not done so by turning a blind eye to these concerns. Rather they have instituted a regulatory regime whose purpose is to ensure that technology and processes are employed to protect consumers and financial institutions. As other nations have found, these risks can be countered and contained, if those institutions operating Internet gambling payment gateways choose to adopt, or are required to adopt, technological systems and processes specifically designed to address each of these problems. The strength of such a system is complemented by the strength of the controls and vigilant oversight of the financial institutions.

OPERATOR ENFORCEMENT SUPPLEMENTING GOVERNMENT ENFORCEMENT

In a prohibition regime, the government has to do all the enforcement, a task that is in practice impossible to achieve. In a regulatory regime, the operator becomes the primary mechanism by which enforcement is undertaken.

In a regulated regime, all consumers wishing to participate in this activity need to establish a player account with a licensed operator. During the registration process the player's identity must be verified. Stringent "Know Your Customer" (KYC) requirements need to be satisfied to confirm the identity, age and residence of the player. When a registered player logs on to participate in the activity, their identity is again verified using a unique identifier generated during the registration process. Additionally, the location of the participant is also checked. Only one account is permitted per player and no payments are made without full verification of the identity of the player.

The operator must also comply with best practices as they relate to responsible gambling measures. These practices include setting player bet limits (individual bet and capped cumulative loss), permitting a player to exclude them self from participating in play, whether at that site or on a broader industry level, and providing players with access to information about their activity.

Technology and processes exist to restrict customers by location. For example, the system used by UC Group in Europe allows for the exclusion of customers based on their location in the event that a jurisdiction chooses to opt out. The individual's location can be identified using IP Geolocation technology. This involves matching the customer's IP address to a specific state and in some cases a specific city or town. This technology is provided by a number of 3rd parties. The accuracy of one of these systems has been independently verified by PricewaterhouseCoopers as 99.9% accurate on a country level and 95% accurate on a state level.

This accuracy can be further enhanced by considering IP location together with both the registration information provided by the customer, the address to which a payment card is registered and the location of the bank that has issued the payment card.

Technology and processes exist to address the risk of underage gambling. Such a system incorporates a number of barriers to prevent abuse by underage persons. The first barrier is at the merchant's website, which must have appropriate age verification mechanisms in place to qualify for services from the operator. The next barrier is provided by the card issuance rules in place for financial institutions.

A key part of addressing the underage gambling risk is the KYC checks undertaken at the point of consumer registration with the merchant.

KYC requires that the organization know whom it is in fact dealing with. In order to satisfy this requirement, the customer is asked for a range of information, including Name, Address, Date of Birth, Telephone Number and information not easily available such as Social Security or Passport Number. This information is then compared to multiple databases to confirm the accuracy and validity. If the customer fails this validation they are unable to open an account. These services are today provided across many industries.

Additional KYC checks performed include checking that the registered address of the telephone number matches the details supplied, and that the customer is in fact able to answer the telephone and confirm these details.

Credit card companies typically do not issue credit cards to minors. Nevertheless, minors may validly have access to debit or sponsored cards. In these cases, the Issuer will be aware of the cardholder's age and is able to decline the transactions flagged as Internet gambling at the time of authorization.

An additional control ensuring use by the legitimate cardholder is provided by the financial institutions and the card schemes through a requirement, at an increasing number of sites, to enter a password before completing an online transaction.

A final impediment to underage usage goes to the heart of this type of system. The underage consumer cannot receive any winnings, as they are not the authorized owner of the card.

Enforcement and compliance with regulations cannot be perfect and requires continuous improvement and enhancement, but this can readily happen in a regulated regime where operators, regulators, and law enforcement work over time to strengthen the integrity of the industry subject to regulation.

This is even true with regard to addressing the risk of compulsive gambling. It is an issue that remains a significant challenge. The solutions are complex and require all participants in this industry to work together in a cooperative way with a combination of education, technology and oversight (parental and/or government). The approach required to effectively combat this requires transparency and involvement from various stakeholders.

A good online system offers a number of opportunities to address compulsive gambling on the Internet that are as good as, if not better than, those available for bricks and mortar gambling.

First, payment card holders can be offered the possibility to restrict their ability to gamble on the Internet by way of applying to be excluded via a self-exclusion pro-

gram. Land-based casinos in the United States already maintain self-exclusion programs but the effect of such a program is normally limited to one casino and subject to the “human error” of individuals in attempting to physically identify excluded persons. When self-exclusion from Internet gambling is put into effect via the payments system, it becomes impossible for the person concerned to participate in any gambling on the Internet that uses traditional card payments through the payment processor. Furthermore, individuals may fix limits on the amounts they can spend on Internet gambling. Increasing such limits is typically subject to cooling off periods after which the individual would need to reconfirm that he or she effectively wants to increase the spending limit. The ideal solution is for a global self-exclusion database to be established and access made available to all financial transaction processors and licensed operators, providing for a broader blocking capability.

Second, an integrity system prohibits individuals from registering more than one payment card to pay for Internet gambling transactions. This would prevent individuals from running up excessive debts by using multiple cards. Similarly players are restricted to only the one account with a licensed operator.

Third, it is relatively simple for a properly designed Internet gambling system to detect an unusual increase in an individual’s spending on Internet gambling. This makes it possible to monitor compulsive gambling much more closely than in the case of traditional forms of gambling where the casinos, lotteries and racetracks normally do not know the identity, or the spending pattern, of most of their customers.

Fourth, as mentioned above the customer’s identity can be verified using 3rd party KYC systems. Once the information has been validated, it can be checked against various databases of compulsive gambling. In the event that a customer is found to be present in these databases, the registration can be rejected or the customer investigated.

All of these kinds of controls make it easier for an enforcement agency, such as the Department of Justice, to protect U.S. consumers, because in such cases, a regulator sets standards, auditors audit them, and a rogue operator can be dealt with as a rogue, an exception to the norm, rather than the norm.

In summary, the most safe and secure way to protect US Citizens who wish to wager online is to regulate the industry, give law enforcement the opportunity to work with US licensed operators and payment service providers and implement the measures outlined earlier in my testimony. I commend to the Judiciary Committee, as an alternative to prohibition, a regulatory structure for dealing with the issue, such as Chairman Frank’s H.R. 2046 initiative, the Internet Gambling Regulation & Enforcement Act 2007, or a similar approach.

I thank the Chairman and Committee Members for the opportunity to submit this testimony.



PREPARED STATEMENT OF NAOTAKA MATSUKATA, PH.D., SENIOR POLICY ADVISOR,
ALSTON & BIRD, LLP

**Statement for the Record of Naotaka Matsukata, Ph.D.
Senior Policy Advisor, Alston & Bird, LLP
To the House Committee on the Judiciary
November 14, 2007**

International Trade and the Online Gaming Case: Preserving the Rules of the System

I am pleased to submit testimony to the committee on a significant matter that demonstrates the relationship between U.S. domestic regulation and our international obligations in commerce and trade. Speaking as a former director of policy planning under United States Trade Representative Robert B. Zoellick, I am grateful to be able to discuss this matter – it is not very often that a trade advisor has the chance to comment on the largest trade dispute in the history of the World Trade Organization.

That assertion might seem a bit strong, but the scope of the issue, in terms of the economic implications, far outpaces any past dispute settled under the World Trade Organization mechanisms. Well worth evaluating, beyond the commercial sanctions now facing the United States in this case, are the policy implications of the Bush Administration's strategy and methods in both the legal and diplomatic phases of the dispute process. It may yet fall to the Congress to restore U.S. respect for, not to mention within, the multilateral trade system before this dispute may be resolved.

In March of 2003, the Caribbean nation of Antigua and Barbuda initiated WTO dispute proceedings against U.S. federal and state laws that prohibited foreign participation in U.S. Internet gambling markets. The WTO ruled, in a November 2004 dispute panel report, and an April 2005 appellate body decision, that the combination of four U.S. federal criminal laws, the Wire Act, the Travel Act, the Illegal Gambling Business Act and the Interstate Horseracing Act, effectively prohibited the cross-border supply of gambling services to the American marketplace. This constituted a violation of commitments made by the United States in the WTO General Agreement on Trade in Services.

Since 2005, the parties have continued to pursue the dispute. The U.S. failed, in 2006, to comply with the WTO ruling that it correct the domestic statutes to abide by the WTO General Agreement on Trade in Services (GATS). Frustrated by its inability to win a respite from the WTO, the Administration this year took the extraordinary measure of announcing its intention to revoke its commitments on gambling services under that agreement, ratified by Congress in 1994.

This development immediately expanded the impact of the dispute beyond the U.S. and Antigua; under WTO rules, the Administration's decision to withdraw GATS commitments automatically entitled any fellow WTO member country to request compensation for the benefits lost by the action. Subsequently, the EU, Japan, Macau,

Costa Rica, India, Australia and Canada joined original disputant Antigua in requesting economic compensation from the United States for the withdrawn trade commitments.

The deadline for these negotiations, conducted under the auspices of WTO arbitrators, is drawing near. Antigua is seeking \$3.4 billion in compensation, while the requests of other countries could exceed \$100 billion. At this time, those countries minimally impacted by the decision, Canada, Australia and Japan, have already informally settled with USTR. It is likely that, for Canada and Australia, some form of protection was afforded through their respective free trade agreements with the United States. As for the remaining countries, most particularly the European Union, which saw companies lose an estimated \$16 billion overnight through the closure of U.S. markets, the Administration has rebuked attempts at a negotiated settlement.

At each step of the process, the Administration has chosen brinkmanship rather than stewardship of the trade system we've so painstakingly constructed over the past six decades. In certain circumstances, this might not be bad trade diplomacy. In this case however, it is potentially disastrous. The WTO found that U.S. gambling laws violated Antigua's trade rights, and ruled the U.S. must reform its laws to comply with its treaty commitments. Compensation arbitration has been extended to December, but if it fails, the aggrieved parties will be entitled to enact sanctions upon the United States to recover their lost benefits. As I stated before, these sanctions could reasonably reach \$100 billion in damages to the U.S. economy. By comparison, in May 2003 the WTO authorized the European Union to enact \$4.034 billion of sanctions on the United States for the failure to reform the Foreign Sales Corporation tax.

Aside from the financial damage, consider the policy implications. Few WTO members will be pleased with this new protectionist precedent, established by none other than the United States. We may count on some countries, however, to be watching the U.S. response to an adverse ruling with great care. China, for instance, continues to complain that its WTO accession commitments have placed a heavy burden on the country, and would clearly welcome a proven method at reducing its obligations in key areas such as agricultural and services trade. Russia, which is now negotiating entry into the WTO, is likely highly receptive to a precedent which would allow Moscow the ability to unilaterally carve back the "commitments" it is now pledging to make to join the club. We should ask whether or not U.S. actions to withdraw our GATS commitments will facilitate similar actions on the part of other trading partners, and, perhaps more importantly, will this action limit our ability to mount an effective response to foreign protectionism. A global trading order doesn't fall all at once, but one rule at a time.

Fortunately, the legislative branch still retains Constitutional authority over trade and commerce. And it is clear that, over the course of the past year, the Congress has successfully reasserted a significant degree of oversight on trade. Legislative solutions to WTO compliance issues are not uncommon remedies. Congress passed a tax bill in 2006 that repealed corporate tax breaks deemed by the WTO to be illegal export subsidies; this

led the European Union to suspend retaliatory trade sanctions. Similarly, in 2005, the Deficit Reduction Omnibus Reconciliation Act addressed WTO concerns over U.S. trade remedy laws.

The historical record clearly demonstrates that, in past instances where the United States has lost in WTO disputes, the executive branch has not hesitated to turn to the Congress; and that the legislature has, in fact, proven to be the definitive authority for ultimately resolving conflict between U.S. domestic regulation and international law. The apparent unwillingness of the United States Trade Representative to consult with Congress toward a legislative solution on this matter is unusual, unexplained, and deserving of appropriate scrutiny. Why has the USTR pursued a risky legal and negotiating strategy in this instance, and is it fully aware of the potential costs of failure?

The agency still appears disinterested in Congressional involvement – and yet it is here in the Congress that a solution is already at hand. House Financial Services Committee Chairman Barney Frank developed legislation that would license U.S. and foreign companies to provide online gaming services, but would allow non-discriminatory regulation at the state level. The Internet Gambling Regulation and Enforcement Act (HR 2046) would provide a regulatory approach consistent with WTO rules regarding discrimination and market access, but honor the sovereignty of the states with respect to the types of gaming allowed in the jurisdictions.

Furthermore, the Frank bill would subject foreign and domestic gaming operators alike to a fair barrier to market entry that will ensure competition among responsible service providers. A proper licensing regime is a source of consumer protection, law enforcement, and taxation that would remain consistent with treaty obligations ratified by the United States in its accession to the WTO.

I would encourage the committee to consider a legislative solution to this matter of U.S. compliance with our commitments to the World Trade Organization. There is little need for brinkmanship to take the country into another fruitless trade war, nor should the United States create precedents that will allow others the latitude to undo the bipartisan, sixty-year effort to build a durable, rules-based global trading system. Thank you.

PREPARED STATEMENT OF I. NELSON ROSE, PROFESSOR OF LAW,
WHITTIER LAW SCHOOL

The federal government has issued proposed regulations to enforce the ban on money transfers for unlawful Internet gambling transactions. The most important thing to understand is that legally nothing has changed. And nothing will, for many, many months.

Given the impossible job of enforcing an unworkable law, regulators punted, issuing proposed regulations that tell banks, credit card companies, e-wallets and other payment processors, basically, "You take care of it."

Because the regulations will expressly put the burden on money transmitters to avoid illegal gambling, financial institutions will increase their restrictions on all gaming, even clearly legal bets.

The proposed regs are the result of a bill rammed Congress through last year by the failed politician, then-Senate Majority Leader Bill Frist (R-TN). Frist attached his Unlawful Internet Gambling Enforcement Act to the SAFE PORTS Act. He refused to let Democrats even read the bill. If they didn't like it, they could vote against port security.

A good indication of how quickly the law was written is that it does not even have a good acronym. Since UIGEA is unpronounceable, I'll call it Prohibition 2.0.

Prohibition 2.0 is often characterized as outlawing Internet gambling in the U.S. It actually does only two things. It creates a new crime: being a gambling business that accepts money for unlawful transactions. And it requires that new regulations be written by the Secretary of the Treasury and Governors of the Federal Reserve Board, in consultation with the Attorney General, meaning the Department of Justice ("DOJ").

What it does not do is make it a crime to merely make bets on the Internet. It doesn't directly restrict players from sending or receiving money. It doesn't spell out what forms of gambling are "unlawful." Specifically, it does not do what the federal Department of Justice ("DOJ") wanted, which was to "clarify" that the Wire Act covers Internet casinos, lotteries and poker.

The new crime it creates is greatly limited. Only gambling businesses can be convicted, not players. Bizarrely, for a law designed to prevent money transfers, the financial institutions involved in those transfers, including banks, credit card companies and e-wallets, are expressly defined as not being gambling businesses and so cannot be convicted of this new crime.

Although a felony, the new crime turns out to be much less than it seems. I have argued (see http://www.GamblingAndTheLaw.com/columns/2006_act.htm) that the Act requires that the gambling already be illegal under some other federal or state law. There has been some discussion that Prohibition 2.0 greatly expanded the reach of anti-gambling laws, to cover overseas operators who were not violating any American law. The comments accompanying the proposed regulations make it clear that the federal agencies, including, most importantly, the DOJ, agree with my analysis. Here's their discussion of whether the government should draw up a list of websites conducting illegal gambling:

The Act does not comprehensively or clearly define which activities are lawful and which are unlawful, but rather relies on underlying substantive law. In order to compile a list of businesses engaged in unlawful Internet gambling under the Act, the Agencies would have to formally interpret the various Federal and State gambling laws in order to determine whether the activities of each business that appears to conduct some type of gambling-related function are unlawful under those statutes.

The regulations were supposed to be promulgated by mid-June. The agencies have finally issued proposed regulations, four months late. The general public now has until December 12 to make comments. The agencies will then make changes in the proposed regs. The final versions will then be published, supposedly giving everyone six months to set up their procedures.

This is not going to happen.

It took ten months just to draw up the proposed regs. The delay was caused not only by having to enforce an unenforceable law, requiring all payment processors to identify and block all unlawful gambling transactions. The other problem is that the three agencies have conflicting goals. The DOJ wants all internet gambling outlawed; Treasury, including the IRS, does not really want it outlawed, it wants to tax it; and Ben S. Bernanke, Chair of the Federal Reserve Board, expressly stated that he opposes any new regulations that would put U.S. banks at a competitive disadvantage with their foreign competitors.

It looks like the Treasury and the Board won most of the fights.

The proposed regs put the burden entirely on payment processors to come up with procedures for identifying and blocking restricted money transfers. But this can't be done in six months. In fact, it can't be done at all.

The problem is defining "unlawful Internet gambling." Even the DOJ admits that some forms of online wagers are perfectly legal. For example, I can sit in my home in Encino, and, using my credit card, make bets by computer with a California licensed racebook. The system is called Advanced Deposit Wagering ("ADW"), since I have to fund my legal bookie account in advance. Congress, in December 2000, amended the Interstate Horseracing Act ("IHA") to make it legal for ADW on horse races, so long as the bets and races were legal under state laws.

And here's an example of why it is impossible to know what is an unlawful gambling transactions. The DOJ agrees that I can make ADW bets with a California licensed bookie on races held here or in any of the 20 other states that have legalized ADW. But everyone else who has read the IHA, including state racing commissions, believes it is perfectly legal for me to set up my ADW with a licensed bookie in another state. So, how is a credit card processor supposed to handle my request to fund an ADW in Oregon?

Everyone agrees that I could not make online bets on horseraces if I were in Utah. So payment processors would have to have cyber-border software to ensure that I don't try to make a bet with my laptop from Salt Lake City. How else will a credit card company or my California bank know not to transfer the money even to a California licensed horsebook?

And what about poker? California has had legal cardrooms since the Gold Rush. But 157 years of bad cases and obscure statutes make it a crime to participate, as a player, in any poker game where the pot is raked more than five times. If the state's laws apply to online poker—a big if—how many payment processors even know what it means to rake a pot five times?

There is, of course, something bizarre about requiring financial institutions to identify and block only unlawful Internet gambling transactions. There is no similar law dealing with importing cocaine or selling child pornography. But, it was clear from the day Prohibition 2.0 passed that there would be loopholes for banks.

Banks do not now read the face of paper checks. Requiring all banks to read 40 billion paper checks each year would cost the industry billions of dollars. Banks lobbied Frist. He added a provision to the Act, allowing Treasury and the Board to decide when it would not be "reasonably practical" to i.d. and block transactions. The DOJ was given no say. So, almost all paper checks are exempt.

In fact, almost all financial transactions are exempt. The agencies were worried about trying to regulate foreign companies. So, it is clear that the regulations apply only to U.S. payment processors. There are some requirements that American financial institutions make inquiries of their foreign partners. But those restrictions will be easy to get around, since an overseas automated clearing house, like its American counterpart, has no way of knowing what transmitted funds are used for.

Significantly, almost everyone involved in the transfer of money is exempt from the requirements of identifying and blocking "restricted transactions." Players are always exempt, whether they are sending money by check or wire, using their credit or debit cards, or getting paid. But all financial intermediaries are also exempt.

The federal agencies understood that it would be impossible for the institutions that transfer trillions of dollars a day around the globe to identify any single transaction. The systems work because the intermediaries know what they need to know and no more: that the bank wiring the funds actually has those funds and the bank requesting the funds is who it says it is. Trying to get any more information, such as whether the wire is for funds to be used for gambling, would cause the entire system to slow down to the point that it would collapse.

Similar thinking went into the other exemptions. The regs "exempt all participants in the Automated clearing house systems, check collection systems, and wire transfer systems, except for the participant that possesses the customer relationship with the Internet gambling business." So, only if an online gaming company is the customer of an American bank will the bank have to ask questions. U.S. financial institutions are supposed to ask foreign payment service providers if the cross-border funds are going to an illegal gambling operator. But what sort of answer do you think they'll get?

More importantly, the regs expressly recognize that there is no way the federal government can tell in advance whether a particular transactions involves unlawful gambling. More than once, the federal agencies expressly turned down the idea of coming up with a list of web operators operating illegal gambling. Banks, being basically conservative, wanted the list so that they would simply not do business with those companies. But even the DOJ acknowledges, as it has to, that not every online wager is illegal.

So the regs put the burden on the credit card companies, banks, e-wallets and other payment processors to come up with their own procedures for checking on whether money is being transferred for unlawful Internet gambling. And there is no way to do that.

Even remote sports betting is sometimes legal, for example intra-state in Nevada. Are bets made with foreign licensed Internet casinos “unlawful gambling transactions?” Show me the state or federal law that you think make them illegal and I will show you the reasons why that law may not apply.

Even when we have a clear statute, there is disagreement. The DOJ believes the Interstate Horseracing Act only allows patrons to bet from their home with horsebooks in their own states. Everyone else, including the World Trade Organization, believes that Act allows cross-border bets. What should a payment processor do?

The answer shows what will happen. Banks and credit card companies can only get into trouble if they permit a transaction that turns out to involve unlawful gambling. They face no penalties for refusing to transfer funds for legal gambling. So, all major American financial institutions will refuse to transfer funds from their patrons to any company that they know is involved with online gaming.

This will open the door to foreign financial operators. Expect to see many more patron solicitations for overseas credit cards and bank accounts.

The proposed regs have so many exceptions that, when they do finally get officially promulgated, Americans will still be able to make bets on the Internet. In the worst case, players can always reload or receive their winnings by paper check.

But there are more loopholes. The regs also clearly do not directly cover financial institutions in other countries. So, anyone who uses a credit card issued by a foreign bank should encounter no trouble. If I send a check from Bank of America to pay off my Hong Kong issued Visa, neither the B of A nor the Hong Kong bank are required to ask whether I’m using the card for gambling.

American payment processors are required to check out payments going in and out of the country. So, a U.S. clearing house is supposed to have procedures in place to check that the money it is forwarding is not used for unlawful gambling. This might be possible if the funds went directly to an online operator or even the operator’s bank. But what if the money went to a foreign clearing house, that cannot possibly know what the funds are used for?

That is the good news for players. The bad news is that we are dealing with banks and other financial institutions that are basically conservative. Also, the DOJ has been waging a war of intimidation on both operators and payment processors—Neteller joined PayPal and credit card companies in voluntarily barring all gaming transactions.

The proposed regs make it clear that payment processors should not block money transfers for legal gambling. They specifically note that some Internet wagers have been declared legal under Prohibition 2.0. These include not only interstate horseracing, but all forms of gambling, including poker, if done correctly and conducted entirely within a single state or on tribal land.

But there is no real downside in telling bank customers and credit card holders that they cannot send any funds to any gambling site. The only thing the banks lose are possibly some customers. But allowing patrons to send funds to a gaming site that turns out to involve an unlawful transaction opens the banks to fines and other government punishments. So, all large U.S. payment processors are going to take the least risky path and block all gambling transactions, even ones that are indisputably legal. There is no law forcing them to transmit funds for legal gambling.

But, in the end, Prohibition 2.0 and its regulations will be as successful in preventing people from gambling and playing poker online as the first Prohibition was in preventing people from drinking.

PREPARED STATEMENT OF RICHARD WINNING, PRESIDENT, THE AMERICAN
GREYHOUND TRUCK OPERATORS ASSOCIATION

Mr. Chairman, thank you for agreeing to submit these comments for the record. As President of The American Greyhound Track Operators Association (AGTOA), I want to highlight the areas of concern raised by the proposed regulation put forth by the Department of Treasury and the Federal Reserve Board, titled “Prohibition On Funding Of Unlawful Internet Gambling”. Below I will highlight areas of concern that the proposed regulation raises including:

- Preventing Over-Blocking of Legal Pari-Mutuel Transactions

- Improving Liability Protection Provisions
- Providing Greater Clarity Reduces Regulatory Burden

Congressional intent is quite clear that legal state licensed and regulated pari-mutuel transactions should be permitted, however, the proposed regulation is far more hazy. The vagueness of the proposed regulation will harm the pari-mutuel industry by incentivizing over-blocking over pari-mutual wagers and cause burdensome regulations where none need exist.

THE AMERICAN GREYHOUND TRACK OPERATORS ASSOCIATION (AGTOA)

The AGTOA was formed in April 1946, and is a non-profit corporation composed of the owners and operators of 36 greyhound tracks located throughout the United States. Membership is open to all lawfully licensed greyhound racetracks, whether they be individuals, partnerships or corporations.

Like horse racing, greyhound racing is recognized as one of the nation's largest spectator sports. Greyhound racing is legal in 16 states including: Alabama, Arizona, Arkansas, Colorado, Connecticut, Florida, Iowa, Kansas, Massachusetts, New Hampshire, Oregon, Rhode Island, South Dakota, Texas, West Virginia and Wisconsin. Further, greyhound racing (as does horse racing) relies upon State authorized pari-mutuel internet and account wagering to facilitate the making of bets or wagers on State sanctioned races.

PREVENTING OVER-BLOCKING OF LEGAL PARI-MUTUEL TRANSACTIONS

The AGTOA would like to make clear that Congressional intent of the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA) is to "ensure that transactions in connection with any activity excluded from the Act's definition of 'unlawful internet gambling'" are not "blocked or otherwise prevented or prohibited by the" the Proposed Regulation. Moreover, the statute states that the regulation should not be implemented as to "alter, limit, or extend Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling within the United States." While the proposed regulation notes these facts, it also contains many drafting contradictions which will lead to over-blocking of legal transactions.

Section 5(c) of the Proposed Regulation currently protects only designated payment system participants who over-block legal transactions while "reasonably" attempting to comply with the regulations. As noted, however, the Proposed Regulations must not be implemented as to "alter, limit, or extend Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling within the United States." This drafting contradiction provides liability protection for over-blocking legal transactions in violation of the Act and wrongly incentivises over-blocking. Moreover, it does not provide sufficient clarity or protection to the banking and financial community who wish to create policies and procedures or otherwise process the same pari-mutuel transactions. Put another way, to be consistent with Congressional intent, there needs to be regulatory parity between those that err on the side of processing legal transactions versus those who over-block.

Congress affirmed that the pari-mutuel industry should be exempt, since it is licensed and regulated by the States. Congress not only stated that the regulated entities permit processing of lawful transactions within the Interstate Horseracing Act, Congress also included that the internet gaming provisions do not change the legality of transactions for dog racing as well. "For instance, if the use of the Internet in connection with dog racing is approved by state regulatory agencies and does not violate any Federal law, then it is allowed under the new sections 5362(10)(A) of title 31," (152 Cong. Rec. H8026-04 (Sept. 29, 2006) (legislative history submitted by Sen. Leach).

The statute also notes that the regulation should not impact state laws. Pari-mutuel betting, account wagering, simulcasting and common pool wagering all use the Internet, and many states have noted this fact. New York sanctions internet pari-mutuel wagering, regulate the gambling activity through their respective State agencies and authorities, and use the internet to reconcile the merged betting pool to facilitate and promote the efficacy of the transactions. Likewise, pari-mutuel account wagering is entirely legal and regulated in many States, including, but not limited to: California, Kentucky, Louisiana, New Jersey, Oregon, and Pennsylvania. All of these transactions involve use of the internet, and are authorized and regulated without regard to whether the race meet is a horse race or dog race, and all of these transactions are in jeopardy.

All of these *lawful* transactions could be in danger because the Proposed Regulation offered by the Administration fails to mirror Congressional language that clearly asserts that legal pari-mutuel wagering is permitted under the UIGEA. We are

not the only organization to read the proposed regulations this way. In the attached comment letter from the Kansas Bankers Association to the Federal Reserve Board, the state association also believes that the over-blocking provisions permit “institutions to decide to completely avoid processing *any* gambling transactions and thereby avoid the potential liability presented by this proposal.” (See attached comment letter from Kansas Bankers Association, October 24, 2007)

The intentional lack of clarity caused by the failure to accurately define “unlawful” gambling activity raises a question about the Proposed Regulation’s fairness. Principles of fundamental fairness require that the Proposed Regulation be sufficiently clear that a person of common intelligence need not guess at its meaning and application. *Kolender v. Lawson*, 461 U.S. 352, 357, 103 S.Ct. 1855, 1858 (1983). As drafted, lawful activity under Federal (e.g., the IHA) and State law (permitting pari-mutuel transactions) is just as likely to be blocked as permitted because a person is left to guess as to whether lawful interstate pari-mutuel wagering is, under the Proposed Regulation, illegal.

The Proposed Regulation intentionally refrains from defining illegal or legal gambling activity. On the one hand, nothing in the Proposed Regulation requires or is intended to suggest that credit card companies, banks and internet payment processors which already handle internet wagers must or should block or otherwise prevent or prohibit any transaction that is not Unlawful Internet gambling. On the other hand, internet and phone account-based pari-mutuel wagering are *de facto* designated as illegal and will be blocked because the Proposed Regulation does not explain that unrestricted transactions include pari-mutuel wagering and are therefore not unlawful internet gambling.

The regulation must follow Congressional intent and expressly denote that legal state transactions, such as those in the pari-mutuel industry, are exempt from the Act. These transactions should not be blocked. Otherwise, the position of the Kansas Bankers Association to consciously over-block will be implemented by financial institutions across the country. This could be the death knell for the entire pari-mutuel wagering industry in the United States, including greyhound racing, an outcome that Congress did not intend nor desire.

IMPROVING LIABILITY PROTECTION PROVISIONS

The Act’s stated purpose is not intended to change the legality of any gambling-related activity in the United States. As drafted, however, the Proposed Regulation only offers liability protection to designated payment system participants who over-block legal transactions. The Administration provided no meaningful guidance or protection to the banking and financial community who wish to avoid over-blocking by creating policies and procedures to process legal State law sanctioned pari-mutuel transactions. By merely extending liability protection to those who over-block in violation of the Act, the Administration wrongly incentivises designated payment system participants to create policies and procedures which will cause in the wholesale prohibition of legal pari-mutuel activity. In turn, the Proposed Regulation effectively encourages a regulatory scheme resulting in legal activity being re-defined as illegal.

The Proposed Regulation needs to be corrected to state that designated payment system participants who follow the Act and process transactions involving State sanctioned and regulated pari-mutuel wagering are immune from liability in the same way as participants who over-block those same transactions in violation of the Act.

PROVIDING GREATER CLARITY REDUCES REGULATORY BURDENS

The Proposed Regulation presents vagueness concerns, and if left unchanged, the Proposed Regulation will be implemented in such a way as to go against Congressional intent; create significant fairness, vagueness and overbreadth concerns; and unduly burden those covered by the Proposed Regulation’s compliance regime.

Greater clarification must be provided as to what is “unlawful internet gambling” to ensure that legal pari-mutuel transactions are protected as Congress expects. The Act makes abundantly clear that the placing of an internet bet or wager that is lawful under Federal or State law is not “unlawful”. Yet, under the Proposed Regulation, a payment processor has no way of knowing whether legal pari-mutuel transactions made over the internet are “unlawful” or permissible.

The Administration has the “responsibility to state with ascertainable certainty what is meant by the standards” in a rule and “to give sufficient guidance to those who enforce . . . , to those who are subject to civil penalties, or to those courts who may be charged to interpret and apply the standards.” *Georgia Pacific Corp. v. OSHRC*, 25 F.3d 999, 1005–1006, (11th Cir.1994); accord, *S.G. Loewendick & Sons, Inc. v. Reich*, 70 F.3d 1291, 1297 (D.C. Cir.1995). The Proposed Regulation fails to

accomplish this. As currently written, the regulation requires designated payment system participants (including financial transaction providers such as credit card companies, banks and money transmittal businesses, such as PayPal) to fashion policies and procedures to comply with the Proposed Regulation in the face of definitional ambiguity (Proposed Regulation at §§ 5–6).

Moreover, the drafting ambiguity created by the Administration makes compliance an onerous and unduly burdensome task. Under section § 5(a) of the Proposed Regulation, participants in designated non-exempt payment systems (which includes financial transaction providers) can (1) simply rely on established written policies and procedures of the payment systems which are reasonably designed to identify, block, and otherwise prevent restricted transactions; or (2) establish and comply with their own written policies and procedures that are reasonably designed to accomplish the same thing. In other words, the Administration causes participants to create policies to block illegal transactions, but does not encourage them to create policies to permit legal transactions, such as those in the pari-mutuel industry.

When presented with a choice of processing pari-mutuel transactions in the face of an ambiguous regulation, payment systems participants will in all likelihood avoid processing such transactions. For example, participants could decide that the financial benefit of handling the transaction is outweighed by the expense of guessing wrong that pari-mutuel wagering is permitted under the Act in violation of the Proposed Regulation. Again, we are already seeing this in the attached letter from the Kansas Bankers Association. By providing clarifications that legal internet pari-mutuel gambling is lawful (or not expressly unlawful), the drafters will conform the Proposed Regulation to Congress's intent to not alter the landscape of legal gambling.

Moreover, clarifying the regulations in this fashion would reduce the burdens placed on designated payment system participants, who would be able to rely on a more fulsome definition of unlawful internet gambling to craft written policies and procedures which do not inadvertently block legal pari-mutuel transactions. In drafting any rule, the Administration should structure it so that the regulated party is given a reasonable opportunity to bring its conduct into conformity with the agency's policy judgments or view of the law. It is not enough for the agency to describe its regulatory goals or regulatory objectives. The agency should give the regulated persons guidelines by which to measure their performance against the agency's or Congress' objectives. (*Atlas Copco, Inc. v. EPA*, 642 F.2d 458, 465 (D.C. Cir.1979)) The proposed regulation fails on this account and greater guidance would lower the burden places on payment processors.

Furthermore, industries need enhanced examples in any regulation to ensure that payment processors clearly understand the breadth of the regulation. One example that payment system participants could do is create procedures that are "reasonably designed" to not block permitted transactions. The creation of a merchant category code ("MCC") for State sanctioned and regulated internet pari-mutuel betting would be one option. With respect to credit card systems, the Proposed Regulation states that MCC codes accompanying a credit card transaction authorization request can be used by payment system participants to separate restricted from unrestricted transactions, however, according to a December 2002 GAO Report titled: "*INTERNET GAMBLING: An Overview of the Issues*," many banks use the same coding for pari-mutuel wagering on horses over the Internet and for other types of on-line gambling, such as online casinos and sports betting. This problem is the result of current limitations in credit card coding programs. The creation of a unique transaction code would still allow the credit card issuers to reject payment for unlawful on-line gambling activities", while accepting lawful internet wagers.

If the Administration proactively suggests that creating a MCC for state sanctioned and authorized pari-mutuel betting are "reasonably designed" to block restricted unlawful transactions, it will not only comply with the Act, but it will also follow suite with Congressional intent and provide greater clarity to the regulated industries.

CONCLUSION

There are several areas of the proposed regulation that are negatively impacting the pari-mutuel industry, many of which are in direct opposition to stated Congressional intent. With regards to the greyhound racing industry, and the pari-mutuel industry as a whole, the regulation should be modified to clearly state that Congressional intent was that State sanctioned and regulated pari-mutuel wagering are immune from liability under the UIGEA. Such a drafting change would add much needed clarity to the Proposed Regulation and prevent over-blocking of legal transactions. Moreover, providing examples of how regulated entities can protect legal

transactions, such as those in the greyhound racing industry, would remove the unintended negative impact that the proposed regulation would create. These small and simple changes would significantly reduce compliance burdens, protect against over-blocking, and allow credit card issuers to create policies and procedures which reject payments for unlawful on-line gambling activities, while accepting internet and account wagers on pari-mutuel races.

We commend the House Judiciary Committee for its oversight of this regulation, and Congress's past efforts to protect the legal state licensed and sanctioned wagering within the pari-mutuel industries. Any regulation must follow Congressional intent and the Act and protect protections to those industries that would be unduly harmed from over-blocking.

PREPARED STATEMENT OF STEVE LIPSCOMB, CHIEF EXECUTIVE OFFICER,
PRESIDENT AND FOUNDER, WPT ENTERPRISES, INC.

Mr. Chairman and Members of the Committee:

My name is Steve Lipscomb. I am the Founder of the World Poker Tour and WPT Enterprises (WPTE) and currently serve as Chief Executive Officer and President of the company.

WHO WE ARE AND WHY WPT OPINION SHOULD MATTER:

In October of 2001, I wrote a business plan with a mission statement "To transform poker into a televised mainstream sports sensation." At that time, poker rooms were closing across the country, the industry was in decline and mainstream celebrity poker players did not exist. Televised poker was poorly conceived, poorly shot and relegated to graveyard time slots on ESPN. And, no one was watching . . .

Legendary entrepreneur, Lyle Berman, and his company, Lakes Entertainment, believed in that business plan and funded the World Poker Tour in December 2001. The best destination casinos in the country (Bellagio, Foxwoods, etc.) signed onto the Tour in early 2002 and the first episode aired in prime time on the Travel Channel on March 30th, 2003. The effect was immediate and lasting. In the first season, the WPT became the highest rated show in Travel Channel history. When ESPN was unable to make a deal to broadcast the WPT in 2002, they re-instated coverage of the World Series of Poker (which had lapsed for three years). And, in 2003, ESPN copied the WPT Television Format when it filmed and captured no-name Chris Moneymaker winning 2.5 million dollars at the Main Event of the World Series of Poker (now known as "the Moneymaker effect").

It took a full eight months to edit the first WPT television show and create the WPT Television format—with interactive graphics that track player's hole cards and "live-fiction" that makes the shows feel like the event is happening when it is broadcast. The result has been a global poker phenomenon—with ESPN, NBC, Fox Sports, Bravo, GSN and numerous international broadcasters copying the WPT Television Format to touch millions of viewers and create a multi-billion dollar poker industry.

WHY WE ARE HERE:

I am submitting testimony today because no one seems to be talking about the remarkable inequities facing legitimate companies in the poker marketplace. The policies of Congress and the Justice Department have combined to create the business equivalent of a perfect storm—rewarding bad behavior and suffocating legitimate U.S. companies that play by the rules. There simply could not be a more inequitable result than the status quo. The Justice Department is on record saying that online poker is illegal in the United States under the Wire Act. Yet, to date, there has been no enforcement of that stance, nor a disavowment of that position. The practical effect has been to freeze out legitimate U.S. companies like MGM, Harrah's and the WPT that choose to respect the stated DOJ position—while rewarding international companies that are willing to take advantage of the lack of enforcement and dismiss or disregard the United States Justice Department.

A year ago, Congress passed the Unlawful Internet Gambling Enforcement Act (UIGEA). However, to date, there has been no "enforcement" under the Enforcement Act. And, that has simply made things worse, not better. Large companies that managed to go public in the United Kingdom prior to UIGEA, left the U.S. market when the law passed—leaving only companies that were willing to fly in the face of BOTH the Justice Department AND the United States Congress. And, those companies are making millions of dollars every day in the U.S. market. They are using

that money to create and give away every product or service that legitimate companies like WPTE and Harrah's might offer—all as loss leaders for their online gaming business. This process is undermining the entire marketplace. WPTE investors have lost over \$300 million dollars in market cap over the last two years as a result of these inequities, while companies that ignore the U.S. authorities have watched their valuations grow into the billions.

An unfortunate side effect is that vulnerable groups that Congress may be trying to protect (children, gambling addicts, etc.) are simply not being protected. It remains easy to play poker online for money in the United States. People simply face having to play on less and less reputable sites. As UIGEA makes it more and more difficult to get money into online poker sites, the sites that are willing to find vendors to unencrypt credit cards or charge credit card transactions deceptively or fraudulently under various misleading merchant codes will prevail in the marketplace. This certainly cannot be the intended result.

WHAT WE CARE ABOUT:

We at the World Poker Tour want a level playing field. We believe that poker should be viewed as a game of skill—and that poker players should be allowed to play poker online anytime they like. We believe that online poker in the United States should be specifically allowed, taxed and regulated. What we do not want to see is this process ending in compromise or deadlock that extends the status quo—or goes back to the pre-UIGEA status quo. If legitimate U.S. companies continue to be excluded from the market out of fear of the United States Justice Department position, while their competitors march forward unabated, the legitimate companies will simply cease to exist.

These hearings and this process have a lot of input from the current online poker sites. They should have a voice. But, their incentives need to be understood. Today they exist in a marketplace that does not allow MGM, Harrah's, WPTE, Yahoo, Google or others to compete with them—and they pay absolutely no tax. The best possible outcome for them would be for nothing to change . . . for as long as they can possibly convince Congress to dance. Because every day . . . they make millions.

CONCLUSION:

We are proud to be a part of the global poker phenomenon. To date we have crowned 79 WPT Poker-Made-Millionaires, given away over 300 million dollars in prize money and helped make dozens of poker players into household names across the country. The American public has embraced poker as a legitimate sport and flocked to the internet to play that sport against other online players around the world. We appreciate the Committee's attempts to resolve these issues and hope a solution can be found to make it possible for U.S. online poker players to play safely in a regulated environment with services offered by U.S. and international websites.

On behalf of WPT Enterprises, Inc., I want to thank you for inviting my testimony. We are committed to working with Congress on these matters and will provide whatever support you and your staff may request.

PREPARED STATEMENT OF HARLAN W. GOODSON,
PRESIDENT, INTERACTIVE SKILL GAMES ASSOCIATION

Mr. Chairman and Members of the Committee, thank you for the opportunity to submit written testimony on behalf of the Interactive Skill Games Association ("ISGA"). We appreciate the Committee examining the important issues surrounding the Unlawful Internet Gambling Enforcement Act ("UIGEA"), and are grateful for your willingness to consider the views of the interactive skill games industry.

ISGA is a trade association created to help shape the growth of the North American interactive skill games sector in compliance with Federal and state law, and to promote public understanding of the sector. A skill game is a contest that is won by the person who plays most skillfully. Well-known skill games include chess and trivia quizzes. They also include competitions in popular casual games, like Bejeweled, Scrabble Cubes and Tetris, in which players compete against other players for cash and prizes. More broadly, they include tournaments that appeal to many adults in the United States and abroad, and range from arcade-style games that may appeal to younger adults, to word or trivia games that may appeal to older

adults. All of the leading Internet sites, including AOL, MSN, Yahoo! and hundreds of other popular Web destinations, offer skill games on their sites.

In contrast to games of chance, no person can expect to win a skill competition by mere random moves or solely as a result of one or more favorable chance events. Instead, skill competitions are based upon the fact that all participants begin on a level playing field and it is the one who plays with the greatest degree of skill who prevails in the end. For example, a two-person solitaire competition, which may be structured much like a duplicate bridge tournament, is distinguished from a game of chance because both players will receive a deck with an identical sequence of cards, thereby requiring the player's skill to determine the winner of a game. Chance is not the determining factor in skill games because skill involves: (a) the exercise of quickness or acuteness of sense perceptions; (b) intellect; (c) keenness of discernment or penetration with soundness of judgment; and/or (d) the ability to see what is relevant and significant. Playing and practicing skill games assists in the development of these skill sets. Ultimately, the player's skill, and not chance or other fortuitous circumstances, is the determining factor in the outcome of skill competitions.

Skill games have significant social value. Skill competitions like spelling bees have long been used to teach valuable skills to children and adults. There is also scientific support for the benefits of skill games. For example, a June 2003 study published in the *New England Journal of Medicine* found a significantly lower cumulative risk of dementia for elderly persons who play skill games compared to those who do not. This study appears consistent with the reduction of the risk of Alzheimer's. In another study, researchers at Case Western Reserve Medical School in Cleveland compared the leisure time activities of more than 550 people, nearly 200 of whom went on to develop Alzheimer's. The study found that "those who had engaged in stimulating activities throughout their life—everything from reading, doing crossword puzzles, and playing bridge, chess, or board games to visiting friends, practicing a musical instrument, and bicycling—were 2½ times less likely to get Alzheimer's."

Interactive skill games are played competitively between individuals, not against the "House" or a "bank", and so the operator has no incentive to make the games particularly hard, other than for the enjoyment of the player. Players typically participate in a community experience, competing with each other in small structured tournaments where the winner takes the pot. Skill game operators act as impartial tournament hosts. They have no vested interest in the outcome of each competition.

Interactive skill games companies are growing quickly in number and size and include companies based in the United States as well as companies owned and operated by multinational media corporations. Building and maintaining skill sites involves many highly skilled individuals including game developers, graphic artists, computer programmers, animators, system analysts, accountants, and many other employees. To pay their employees and add value for customers, skill games companies need to have revenue which is typically generated by collecting user fees. These fees are typically modest as competition tends to set pricing. The most common method is to invite persons to compete in a tournament or competition for a small fee with a cash or merchandise prize. This is akin to local bowling tournaments, spelling bees, baking contests or cheerleading competitions, where competitors pay a small entrance fee to enter and have the opportunity to win prizes. The entry fees defray the cost of hosting the competitions and furnishing prizes. The most common skill game tournaments involving 2–3 players have typical entry fees of approximately \$2.00 for a game that will generally last from three to five minutes with an average prize of about \$6.00.

For several years, the interactive skill games industry has steadily grown to serve millions of Americans. These players are not persons who you will read about in the media as either having won millions (like the latest state lottery winners) or who suffer devastating losses because of a gambling problem. The skill games players are simply everyday folks who enjoy entertaining themselves by participating in challenging skill competitions. According to industry surveys, two-thirds of the players frequenting skill games sites are women, with more than half between the ages of 25 and 54. Additionally, most of the players are married, and many have children. The players are drawn to skill games competitions for the challenge of competing against other players of equal ability, and also the mental escape associated with being engrossed in their favorite word, card or arcade games. Yet, the skill games industry has been drawn into a debate that is not pertinent to its industry but where the fallout from the debate and related federal government action threaten its very existence.

The debate over the social ills some people associate with gambling resulted in the passage of the UIGEA. The ISGA believes that the proposed regulations imple-

menting UIGEA will have a profound negative impact on this legal and socially beneficial past time which is not, and should not be considered, gambling. UIGEA was enacted in response to the growth of the Internet gambling industry. That it never was intended to apply to pure skill games just because they can be played over the Internet is evident by legislative history. Yet, contrary to congressional intent in passing UIGEA, proposed federal regulations could unduly restrict the lawful skill games industry.

Under UIGEA, two agencies, the Board of Governors of the Federal Reserve System and Departmental Offices and the Department of the Treasury (collectively the "Agencies"), had a nine-month period (until July 2007) to propose rules (in consultation with the Department of Justice) to implement applicable provisions of UIGEA. Specifically, these regulations were intended to provide guidance to the payment systems used by credit card companies, banks, payment networks including electronic fund transfers ("EFT"), stored value or money transmitting services, EFT terminal operators, and money transfer businesses (hereinafter, the financial transaction providers, or "FTP") to: (a) identify and code restricted transactions; and (b) block the restricted transactions.

Restricted transactions are those transactions through which a gambling business accepts funds directly or indirectly from a player in connection with unlawful Internet gambling. UIGEA defines "unlawful Internet gambling" as "to place, receive, or otherwise knowingly transmit a bet or wager by any means which involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or state law in the state in which the bet or wager is initiated, received, or otherwise made."

None of these definitions has any application to skill games. Simply, UIGEA was not intended to block lawful gaming transactions such as skill games. The proposed Agency rules, however, do not attempt to distinguish lawful skill competitions from illegal gambling games. The proposed regulatory solution as it relates to distinguishing legal and illegal gambling transaction is to shift the burden to particular FTPs in the financial transaction chain, with no guidance and only downside regulatory liability. Consequently, the regulations, as written, place the entire burden as to what are "lawful" or "unlawful" transactions on the FTPs.

The proposed Agency rules require certain FTPs to establish policies and procedures to terminate relationships with others who they think may have any connection with unlawful Internet gambling. By not defining "unlawful Internet gambling" the FTPs are left to simply apply whichever standards they decide to adopt. Some have indicated that they will terminate any relationship with those who offer competitions for prizes because the cost of doing due diligence to assure that the competitions are skill-based is too high. This results in shifting the fundamental purpose of the rulemaking under UIGEA to the FTPs to make policy and procedural decisions central to implementing UIGEA.

The Agencies have justified the refusal to establish procedures to ensure that legal gambling transactions are not blocked by claiming that "UIGEA does not provide the Agencies with the authority to require designated payment systems or participants in these systems to process any gambling transactions, including those excluded from the UIGEA's definition of unlawful gambling if a system or participant decides for business reasons not to process such transactions." Yet, the primary business reason for terminating business with skill-based companies is that the failure to adopt clear standards in the rulemaking process creates due diligence costs that can be avoided by simply excluding service to the lawful skill games industry.

Most financial institutions want no part of the expense associated with this monumental undertaking and lack the necessary knowledge to conduct such an investigation into the legality of different Internet activities (whether it be illegal versus legal gambling or illegal gambling versus legal skill competitions). Therefore, their natural inclination is not to engage in any reasoned analysis to distinguish between a lawful industry like that represented by ISGA, but to assume that all transactions involving prizes are restricted and to ban any contact with the financial institutions' counterparts that deal in any way with sites that allow persons to win anything. For instance, as the commentary in the proposed regulations already notes: "payment system operators have indicated that, for business reasons, they have decided to avoid processing any gambling transactions, even if lawful. . . ." This is the natural inclination not only for lawful gambling transactions but also lawful skill contests and competitions. The skill games industry is already experiencing significant instances of financial institutions engaging in this reasoning.

The debate surrounding Internet gambling is not our debate, yet the consequences of the proposed remedy profoundly impact our business, our customers and our employees. Defining lawful skill games is not a difficult challenge. For example, the UIGEA contains an exception for fantasy sports. Without debating the relative mer-

its of the skill aspects of fantasy sports versus, for example, chess, the exemption shows that carefully drafted definitions can easily protect the skill games industry without compromising the intent of UIGEA.

A great disservice is being done to millions of Americans who play skill games, to the companies and their investors that have built the legal skill games industry and to the thousands of skilled workers who earn a living in this vibrant industry.

We urge Congress to carefully review this issue and further clarify to the Federal Reserve Board and the Department of Treasury that they have an affirmative obligation to protect innocent industries from collateral damage resulting from the Internet gambling debate.

Mr. Chairman and Members of the Committee, thank you again for the opportunity to present ISGA's views on these important issues. I am available to discuss these issues further with Members and staff of the Committee.

